STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Case 07-M-0906 - Joint Petition of Iberdrola, S.A., Energy East Corporation, RGS Energy Group, Inc., Green Acquisition Capital, Inc., New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation for Approval of the Acquisition of Energy East Corporation by Iberdrola, S.A.

Evidentiary Hearing
3 Empire State Plaza
Albany, New York

Tuesday, March 18, 2008
9:00 a.m.

PRESIDING:

RAFAEL A. EPSTEIN,
Administrative Law Judge

ORIGINAL

JUDGE EPSTEIN: I call Case 07-M-0906, continuing the evidentiary hearing in the matter of Iberdrola. Are there any active parties here who did not enter an appearance yesterday?

(No response.)

JUDGE EPSTEIN: No other active parties?

(No response.)

JUDGE EPSTEIN: Okay. Let's see.

I'll continue without the mic until they get that resolved. As yesterday, we are web casting at this time, and we believe that we are being monitored by telephone, but we believe that parties don't have the capacity to call in because of the problems we were having yesterday.

If anybody is looking for a room for either a conference or to monitor the proceedings here using your cell phone, today, there is the small conference room on the third floor, the ADR room available from 12:00 to 5:00.

And I have been asked to note the appearance of Mr. Martinez, Luis Martinez, for the Natural Resources Defense Council for the limited purpose of introducing the testimony of Mr. Gupta and an associated exhibit which we will do after completing the cross of Petitioners' witnesses.

Is there any other preliminary business?

(No response.)

JUDGE EPSTEIN: Okay. Off the record.

(Discussion off the record.)

JUDGE EPSTEIN: We're back on the record, and if there's no other preliminary matters, then the next order of business is the cross of this panel; is that correct.

MR. FITZGERALD: Correct, your Honor.

JUDGE EPSTEIN: Do you want to call the panel?

MR. FITZGERALD: Yes, your Honor. The Joint Petitioners call the Benefits and Public Interest Panel and the Policy Panel, which consists of the same individuals, Pedro Azagra, James Laurito and Robert Rude.

JUDGE EPSTEIN: Please rise.

P E D R O   A Z A G R A,

J A M E S   L A U R I T O,

R O B E R T   R U D E,

having first been duly sworn by the Administrative Law Judge, were examined and testified as follows:

DIRECT EXAMINATION

BY MR. FITZGERALD:

Q. Good morning, panel. Mr. Azagra, would you please state your name and address for the record.

A. (Mr. Azagra) Pedro Azagra, Tomas Redondo 1, Madrid, Spain.

Q. Mr. Laurito, would you please state your name and business address for the record.

A. (Mr. Laurito) Yes. Jim Laurito, NYSEG and RG&E, 89 East Avenue, Rochester, New York.

Q. Mr. Rude, would you please state your name and business address for the record as well.

A. Robert E. Rude, 52 Farm View Drive, New Gloucester, Maine.

Q. I'd like to begin the panel this morning with their direct. Do you have before you a 27-page document, questions and answers entitled, "The Direct Testimony of the Benefits and Public Interest Panel," dated August 1, 2007?

A. (Mr. Laurito) Yes.

A. (Mr. Rude) Yes.

A. (Mr. Azagra) Yes.

Q. Was that document prepared by you or under your direction?

A. (Mr. Laurito) Yes.

A. (Mr. Azagra) Yes.

A. (Mr. Rude) Yes.

Q. Do you have any corrections or changes to the direct testimony today?

A. (Mr. Azagra) No.

A. (Mr. Rude) No.

A. (Mr. Laurito) No.

Q. If I were to ask you the questions set forth in your prefiled direct testimony, would your answers be the same as set forth in that testimony today?

A. (Mr. Rude) Yes.

A. (Mr. Laurito) Yes.

A. (Mr. Azagra) Yes.

Q. Do you adopt that prefiled testimony as your sworn direct testimony in this proceeding?

A. (Mr. Laurito) Yes.

A. (Mr. Rude) Yes.

A. (Mr. Azagra) Yes.

MR. FITZGERALD: Your Honor, may we have the prefiled direct testimony of the Benefits and Public Interest Panel copied into the record as if given orally?

JUDGE EPSTEIN: Yes.

(The following is the prefiled direct testimony of the benefits and public interest panel:)

BENEFITS AND PUBLIC INTEREST PANEL

I. INTRODUCTION

Q. Please state the names of the members on this Benefits and Public Interest Panel (the "Panel").

A. Our names are Pedro Azagra Blazquez, James P. Laurito and Robert E. Rude.

Q. Mr. Azagra, please state your current position and business address.

A. My title is Director of Corporate Development of IBERDROLA, S.A. ("IBERDROLA"). My business address is Tomás Redondo 1, Madrid, Spain, 28033.

Q. What are your current job responsibilities?

A. Among other things, I am responsible for the non-organic growth of IBERDROLA, which includes such transactions as mergers, acquisitions, divestitures of core businesses, and the strategic planning of such opportunities.

Q. Please summarize your educational background.

A. I received a business degree and a law degree from Icade University in Madrid, and a Master of Business Administration from the University of Chicago.

Q. Please describe your work experience.

A. Prior to joining IBERDROLA, I worked at Morgan Stanley from 1992 to 1996 in the Investment Banking Division in London.

Q. Have you previously testified before any United States federal or state regulatory agency or a regulatory agency of another country?

A. I have never provided testimony, but I have done significant work related to IBERDROLA regulatory matters in Spain.

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Q. **Please identify those areas of the testimony for which you have primary responsibility.**

A. While we are collectively sponsoring this Panel testimony with respect to the overall transaction (the "Proposed Transaction") that is described in the "Joint Petition for Approval of the Acquisition of Energy East Corporation by IBERDROLA, S.A." (the "Joint Petition") to which our testimony is attached, I am responsible for the portions of this testimony related to IBERDROLA's global operations and experience, IBERDROLA's strategic plan, IBERDROLA's commitments, IBERDROLA's business focus and philosophy, and the overall purpose of the Proposed Transaction from IBERDROLA's perspective. The Panel as a whole is responsible for describing the reasons why the Proposed Transaction should be approved as in the public interest. I defer to Mr. Laurito and Mr. Rude with respect to the specific factual statements in this testimony with respect to Energy East.

Q. **Mr. Laurito, please state your current position and business address.**

A. My title is President and Chief Executive Officer ("CEO") of New York State Electric & Gas Corporation ("NYSEG"), President and Chief Executive Officer of Rochester Gas and Electric Corporation ("RG&E"). My business address is 89 East Avenue, Rochester, New York 14649.

Q. **What are your current job responsibilities?**

A. As President and CEO of NYSEG and RG&E, I am ultimately responsible for the overall day-to-day operations of the companies. I am responsible, among other things, for maintaining NYSEG's and RG&E's financial health, enhancing the operating efficiency and reliability of NYSEG's and RG&E's electric and gas businesses, and assuring that all functions are carried out in compliance with local, state and federal laws and regulations and standards of good business practice. I am ultimately responsible for assuring that NYSEG and RG&E provide customers with safe and reliable electric and gas service.

Q. **Please summarize your educational background.**

A. I graduated from West Virginia University with a Bachelor of Science Degree in Civil Engineering and have completed executive programs in financial and manufacturing management at Columbia University.

Q. **Please describe your work experience.**

A. I have been President and CEO of RG&E since June 2003 and President and CEO of NYSEG since May 2003. In addition, I served as NYSEG's Treasurer from May 2003 to July 2003; President and Chief Operating Officer of Connecticut Natural Gas Corporation and The Southern Connecticut Gas Company (Energy East's two local distribution companies in Connecticut) from October 2000 to May 2003; President of TEN Companies, Inc. ("TEN") (a CTG Resources, Inc. affiliate) from January 1998 to October 2000; and Vice President of Business Development of TEN from September 1997 to January 1998.

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Q. Have you previously testified in other proceedings before the New York State Public Service Commission ("PSC" or the "Commission") or other state or federal regulatory agency or court?

A. No.

Q. Please identify those areas of the testimony for which you have primary responsibility.

A. While we are collectively sponsoring this Panel testimony with respect to the Proposed Transaction, my primary areas of responsibility are with respect to NYSEG and RG&E service reliability, infrastructure capital investment, employee matters, and community matters. I defer to Mr. Azagra with respect to the specific factual statements in this testimony with respect to IBERDROLA.

Q. Mr. Rude, please state your current position and business address.

A. My title is Senior Vice President and Chief Regulatory Officer of Energy East and Energy East Management Corporation ("EEMC"). My business address is 52 Farm View Drive, New Gloucester, Maine 04260-5116.

Q. Please summarize your educational background.

A. I graduated from the State University of New York, College at Geneseo, in 1974, with a Bachelor of Arts Degree in Political Science. I obtained a Masters Degree in Business Administration from Syracuse University in 1993.

Q. What are your current job responsibilities?

A. As Senior Vice President and Chief Regulatory Officer, I am responsible for all regulatory policy and proceedings at Energy East's electric and natural gas utility

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operating companies. I am also responsible for operating and capital budgeting at Energy East.

Q. **Please describe your work experience.**

A. I have been Senior Vice President and Chief Regulatory Officer of Energy East since June 2005. I served as Vice President and Controller of Energy East from November 1999 to June 2005, and also served as Energy East's Principal Accounting Officer prior to June 2005. In addition, I served as Controller from October 1998 to November 1999; Executive Director, Corporate Planning of NYSEG, October 1998 to October 2000; and Director, Corporate Planning and Rates of NYSEG prior to October 1998.

Q. **Have you previously testified in other proceedings before the Commission or other state or federal regulatory agency?**

A. Yes. I have testified in Commission proceedings involving electric rate settlements, electric rate design and industry restructuring. For example, I have testified before the Commission in Cases 94-M-0349 (NYSEG Electric and Gas Rates), 96-E-0891 (NYSEG Restructuring), 01-E-0359 (NYSEG Electric Price Protection Plan) and 01-G-1668 (NYSEG Gas Rates)/01-G-1683 (Deferral Petition – Gas Costs). I have also testified in a number of proceedings before the Connecticut Department of Public Utility Control and the Maine Public Utilities Commission.

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Q. Please identify those areas of the testimony for which you have primary responsibility.

A. While we are collectively sponsoring this Panel testimony with respect to the Proposed Transaction, my primary areas of responsibility are issues relating to the previous Energy East mergers, ongoing regulatory proceedings, rates and tariffs, Energy East allocation methods and accounting, and the purpose of the Proposed Transaction and the reasons it should be approved from Energy East's perspective. I defer to Mr. Azagra with respect to the specific factual statements in this testimony with respect to IBERDROLA.

Q. What is the overall purpose of the Panel's testimony?

A. The purpose of our testimony is to demonstrate why the Proposed Transaction is in the public interest and to provide overall support for the Joint Petition, which is being filed contemporaneously with this testimony.

Q. Please briefly describe the Joint Petition.

A. The Joint Petition of IBERDROLA, Energy East, Green Acquisition Capital, Inc. ("Green Acquisition"), RGS, NYSEG and RG&E (collectively, the "Joint Petitioners") requests Commission approval, without modification or condition, pursuant to Section 70 of the New York Public Service Law ("PSL"), of the Proposed Transaction, pursuant to which IBERDROLA will acquire 100 percent of the common stock of Energy East. More particularly, the Joint Petitioners request the necessary approvals for the Proposed Transaction to be completed in accordance with the provisions of the Agreement and Plan of Merger, dated as of

June 25, 2007, among IBERDROLA, Green Acquisition and Energy East (the "Merger Agreement"), without condition or modification. Pursuant to the Merger Agreement, Green Acquisition, a New York corporation and wholly-owned subsidiary of IBERDROLA formed for the purpose of effectuating the Proposed Transaction, will merge with and into Energy East, with Energy East as the surviving entity. Therefore, as a result of the Proposed Transaction, Energy East will become a wholly-owned subsidiary of IBERDROLA, and Energy East's subsidiaries will become subsidiaries of IBERDROLA. The Merger Agreement is attached to the Joint Petition as Exhibit 8.

Q. **Please describe how this testimony supports the Joint Petition.**

A. To obtain the Commission's consent for the Proposed Transaction, the Joint Petitioners must show that the Proposed Transaction is in the public interest. This testimony, in conjunction with the Joint Petition, supports such a finding.

Q. **Are the Joint Petitioners requesting Commission approval of the Proposed Transaction by a specific date?**

A. Yes. The Joint Petitioners desire to complete the Proposed Transaction expeditiously so that the benefits of the Proposed Transaction can begin to be realized as quickly as possible, and to close the Proposed Transaction promptly following satisfaction of all conditions precedent to the Proposed Transaction, which include regulatory authorization by the Commission. It is important, therefore, that the Commission act promptly on this Joint Petition. Accordingly, the Joint Petitioners respectfully request that the Commission approve the

Proposed Transaction without modification or condition within six (6) months of the date of filing. A schedule calling for a decision by such time will provide a full opportunity for review, including public input.

Q. **Is this Panel sponsoring any exhibits?**

A. This Panel will address and discuss the exhibits to the Joint Petition, with the number designations and descriptions as listed in the Joint Petition. Several of the Joint Petition exhibits are referenced and described in our testimony.

Q. **Please describe the organization of the rest of your testimony.**

A. Section II of our testimony provides an Executive Summary of the benefits of the Proposed Transaction. Section III describes the Joint Petitioners, including background information about IBERDROLA's global utility operations and interests in the United States, and the mechanics of the Proposed Transaction. Finally, Section IV describes the benefits of the Proposed Transaction and demonstrates that the Proposed Transaction is in the public interest, as required by PSL Section 70.

II. <u>EXECUTIVE SUMMARY</u>

Q. **What is the overarching reason why the Commission should approve the Proposed Transaction?**

A. The Proposed Transaction should be approved because it will result in numerous benefits for NYSEG and RG&E customers and New York generally. Furthermore, IBERDROLA and Energy East are making commitments that protect NYSEG and RG&E ratepayers from costs incurred to consummate the

Proposed Transaction, including any acquisition premium. As such, the Proposed Transaction is in the public interest.

Q. Is the Proposed Transaction intended to be a merger of two operating entities for the realization of savings?

A. No. The Proposed Transaction represents an acquisition by IBERDROLA at the Energy East holding company level, rather than a combination of the operations of individual operating companies. While the Proposed Transaction will not result in the synergistic savings that sometimes accompany mergers where the operations of individual operating companies are combined, New York customers will nonetheless benefit from NYSEG and RG&E becoming part of IBERDROLA.

Q. How will New York benefit from the Proposed Transaction?

A. IBERDROLA is a leading global utility and energy company with a market capitalization of approximately $70 billion (utilizing an exchange rate of $1.35/Euro). It has the financial, technological and managerial capabilities, honed by over 100 years of utility experience, to acquire control of Energy East while ensuring that NYSEG and RG&E continue to provide high-quality, safe, and reliable service to their customers. IBERDROLA brings to New York a proven record of providing high-quality electric distribution service and a demonstrated commitment to innovation, infrastructure investment, service quality, efficiency, clean energy policies, and sustainable development. IBERDROLA strives to achieve its business objectives while meeting customer needs, with a focus on security of supply and climate change issues. IBERDROLA's policies and plans affecting customers, shareholders, and employees are guided by principles of corporate social responsibility. In addition to IBERDROLA's commitment to energy efficiency and the environment, IBERDROLA is well-capitalized, has considerable liquidity, strong credit ratings, and ready access to international as well as domestic capital markets.

III. DESCRIPTION OF THE JOINT PETITIONERS AND THE PROPOSED TRANSACTION

A. Description of the Joint Petitioners

IBERDROLA

Q. What is IBERDROLA's corporate structure and primary business?

A. IBERDROLA is a corporation (*Sociedad Anónima*) organized under the Laws of the Kingdom of Spain whose shares are publicly traded on the Madrid Stock Exchange. IBERDROLA's principal place of business is located at Calle Cardenal Gardoqui, 8 48008, Bilbao, Spain. A description of IBERDROLA's key officers and management personnel is set forth in Exhibit 2 to the Joint Petition and a copy of its Certificate of Formation is attached to the Joint Petition as Exhibit 1.

Q. What is IBERDROLA's scope and scale of operations?

A. IBERDROLA is a global utility that has over 100 years of experience in the electric and gas business, including experience as a provider of electric transmission and distribution services. It is one of the largest energy companies in the world with a market capitalization of approximately $70 billion. IBERDROLA provides services to approximately 22 million electric points of supply and 2 million gas points of supply in Europe and the Americas, including 10 million electric points of supply in Spain, 7.7 million in Brazil, 3.4 million in the United Kingdom and approximately 1 million in Guatemala and Bolivia. IBERDROLA is also engaged in the natural gas business in Europe and the Americas, as a gas supplier and developer of gas infrastructure.

Q. **Please describe IBERDROLA's natural gas operations.**

A. IBERDROLA is engaged in the natural gas business in Europe and the Americas, as a gas supplier and developer of gas infrastructure. In Spain, IBERDROLA supplied 150 bcf of natural gas in 2006, including 20 percent of Spain's liquefied natural gas supplies. IBERDROLA also has significant investments in two Spanish re-gasification plants and in the MEDGAZ pipeline, which transports supplies from Algeria to Spain. IBERDROLA also is the third largest independent operator of natural gas storage in North America, with almost 95 bcf of storage capacity. IBERDROLA has signed long-term supply contracts for 565 bcf annually (247 bcf in Spain and 318 bcf in Latin America), allowing IBERDROLA to reduce its exposure to fuel price volatility.

Q. **Please describe IBERDROLA's experience in the operation of electric distribution networks.**

A. IBERDROLA operates an electric distribution network in Spain with over 218,000 kilometers (130,000 miles) of distribution and transmission lines. In

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2006 alone, IBERDROLA invested over $675 million in expansion and improvement of its electric distribution networks in Spain. Pursuant to its strategic plan, IBERDROLA focuses on reducing power failure rates, repowering existing lines and using existing rights-of-way to avoid disruption from construction of infrastructure improvements, reducing losses through the installation of capacitor banks, increasing voltage to increase capacity, and updating facilities with state-of-the-art "low-loss" transformers.

Q. **Is IBERDROLA currently engaged in utility or non-utility energy business activities in the United States?**

A. IBERDROLA is not currently engaged in any traditionally regulated transmission or distribution utility operations in the United States. However, in April 2007, IBERDROLA completed its acquisition of Scottish Power, plc ("ScottishPower"), expanding its business activities in Europe and the United States. ScottishPower is involved in the generation, transmission, distribution and supply of electricity, as well as the storage and supply of natural gas, in the United Kingdom. Through ScottishPower's subsidiary, PPM Energy, Inc. ("PPM"), IBERDROLA is now engaged in renewable generation, gas storage and associated energy management activities in the United States and Western Canada. Additionally, since May 2006, IBERDROLA has acquired three renewable energy companies in the United States (i.e., Community Energy in May 2006; MREC Partners in October 2006, and CPV Wind Ventures, LLC in April 2007).

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Q. What wind energy assets does IBERDROLA own and/or operate in New York State?

A. PPM, through certain subsidiaries, holds a 50 percent interest in Flat Rock Windpower, LLC ("Flat Rock) which owns a 231 MW generating project and Flat Rock Windpower II, LLC ("Flat Rock II"), which owns a 90.75 MW generating project. Each of these projects is interconnected to the Niagara Mohawk Power Corporation transmission system, which is operated by the New York Independent System Operator, Inc. Flat Rock and Flat Rock II are both Exempt Wholesale Generators, and have been authorized by the Federal Energy Regulatory Commission to make sales of electric energy and related products at market-based rates.

Q. What, if any, wind energy projects are being developed by IBERDROLA in New York State?

A. A subsidiary of IBERDROLA is currently developing a 110 MW wind energy project in Herkimer County, New York, which is expected to achieve commercial operation in 2008.

Q. Can you describe IBERDROLA's commitment to sustainable development?

A. Sustainable development is the cornerstone of IBERDROLA's strategic plan, which is premised on using technologies that are cleaner, more efficient and environmentally friendly. IBERDROLA has demonstrated its commitment to renewable energy and the environment by developing world-class expertise in delivering sustainable, clean energy. IBERDROLA has followed a strategy of

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growth in the renewable energy field that reflects IBERDROLA's support for the Kyoto Protocol and the European Union Emissions Trading Directive.

Q. **How large is IBERDROLA's portfolio of renewable resources?**

A. IBERDROLA owns a diversified portfolio of approximately 40,000 MW of electric generation, including approximately 10,000 MW of hydro power and over 6,800 MW of renewable wind generation resources. In 2006 alone, IBERDROLA invested over $1.32 billion in renewable technologies and has over 40,000 MW of new renewable resources in the pipeline, including over 20,000 MW in the United States.

Q. **Has IBERDROLA been recognized for its environmental sustainability policies?**

A. Yes. IBERDROLA has received international recognition for its environmental policies and performance, including rankings of best in class for both the Electric Utilities Category for environmental behavior by Storebrand Investments and for the global level in the 2006 Climate Leadership Index. Moreover, IBERDROLA has been named a leader in the Worldwide Utilities Category of the Dow Jones Sustainability Index, identified as one of the 50 best companies in climate strategy, and is listed as one of the Global 100 Most Sustainable Corporations in the World and among the top three companies in the Energy & Utilities Sector Category in the Pacific Sustainability Index.

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Green Acquisition

Q. Please describe Green Acquisition.

A. Green Acquisition is a New York corporation and a wholly-owned subsidiary of IBERDROLA that was formed solely for the purpose of merging with and into Energy East in the Proposed Transaction. Its function is to be IBERDROLA's acquisition subsidiary and ultimately, as set forth in the Merger Agreement, it will be merged with and into Energy East. At that time, the separate corporate existence of Green Acquisition will cease and Energy East will be the surviving corporation wholly-owned by IBERDROLA. IBERDROLA will provide Green Acquisition with the financial resources needed to carry out the Proposed Transaction. Green Acquisition's Certificate of Incorporation is attached to the Joint Petition as Exhibit 3.

Energy East

Q. What is Energy East's corporate structure and primary business?

A. Energy East is a public utility holding company with operations in New York, Connecticut, Massachusetts, Maine, and New Hampshire, serving approximately 1.8 million electric customers and 900,000 natural gas customers. Energy East's corporate and administrative offices are located in New Gloucester, Maine and Rochester, New York. Energy East's principal business subsidiaries are engaged in regulated electric transmission, distribution and generation operations in upstate New York and Maine and in regulated natural gas transportation, storage and distribution operations in Connecticut, upstate New York, Maine,

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Massachusetts, and New Hampshire. Energy East also has two service company affiliates, Energy East Shared Services Corporation and EEMC, that provide back office services to its affiliates, and has a 100 percent indirect ownership interest in several subsidiaries that are not traditional public utilities.

RGS

Q. What is RGS's corporate structure and primary business?

A. RGS is a holding company organized under the laws of State of New York. As we noted earlier in our testimony, RGS is a wholly-owned subsidiary of Energy East. RGS is the intermediate holding company for NYSEG and RG&E. The corporate headquarters of RGS are located in Rochester, New York. RGS's Certificate of Incorporation is attached to the Joint Petition as Exhibit 5.

NYSEG

Q. What is NYSEG's corporate structure and primary business?

A. NYSEG is a regulated public utility engaged in the generation (hydro), purchase, distribution and transmission of electricity, and the purchase, distribution and transportation of natural gas in the central, eastern and western parts of the State of New York. NYSEG has approximately 870,000 electric and 257,000 gas customers. NYSEG's corporate headquarters are located in Rochester, New York and its operations center is located in Binghamton, New York. NYSEG's Certificate of Incorporation, as amended, is attached to the Joint Petition as Exhibit 6.

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RG&E

Q. What is RG&E's corporate structure and primary business?

A. RG&E is a regulated public utility engaged principally in the business of generating, purchasing, transmitting and distributing electricity, and purchasing, transporting and distributing natural gas in nine upstate New York counties. RG&E has approximately 359,000 electric and 297,000 gas customers. RG&E's corporate headquarters and operations center are located in Rochester, New York. RG&E's Certificate of Incorporation, as amended, is attached to the Joint Petition as Exhibit 7.

B. Description of the Proposed Transaction

Q. Please describe the Proposed Transaction.

A. Pursuant to the Merger Agreement, IBERDROLA will acquire 100 percent of the common stock of Energy East and the shareholders of Energy East will receive, in consideration for their shares, $28.50 in cash per share. The total consideration that Iberdrola will pay to Energy East shareholders, based upon the number of Energy East shares outstanding of approximately 158 million as of June 25, 2007, is approximately $4.5 billion. As noted earlier in our testimony, the Proposed Transaction will be implemented by means of the merger of Green Acquisition with and into Energy East, with Energy East as the surviving corporation that will be a wholly owned subsidiary of IBERDROLA.

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Q. Does the Joint Petition contain exhibits illustrating the corporate organizational effects of the Proposed Transaction?

A. Yes. The current corporate organizational chart for Energy East, including the New York utility subsidiaries of Energy East (*i.e.*, NYSEG and RG&E), is attached to the Joint Petition as Exhibit 9. Exhibit 10 of the Joint Petition contains the corporate organizational charts of IBERDROLA both prior to and after the Proposed Transaction.

Q. How will IBERDROLA finance the Proposed Transaction?

A. On June 27, 2007, IBERDROLA sold 85 million new shares of common stock through an accelerated private placement that was fully subscribed, providing IBERDROLA with approximately $4.5 billion for Green Acquisition to proceed with the Proposed Transaction. Thus, the cash consideration payable to Energy East shareholders has already been financed through the proceeds of the capital issuance realized through this single equity placement, and will not result in any new debt for Iberdrola, Energy East or their subsidiaries. This deal structure allows IBERDROLA to maintain a solid financial position, and eliminates the need for any financing contingency that needs to be satisfied prior to the closing of the Proposed Transaction.

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IV. PUBLIC INTEREST DEMONSTRATION

Energy East and its Utility Subsidiaries Will Benefit from IBERDROLA's Utility Expertise

Q. You mentioned earlier in your testimony that the Proposed Transaction represents an acquisition by IBERDROLA at the Energy East holding company level rather than a combination of the operations of individual operating companies that would result in synergistic savings. As that is the case, what benefits will Energy East and its subsidiaries obtain from the Proposed Transaction?

A. Energy East and its utility subsidiaries will obtain benefits from IBERDROLA's global utility and other energy expertise and managerial talent. As we indicated earlier in our testimony, IBERDROLA, through its affiliates, is a world leader with a proven record of providing high-quality electric distribution service. It is one of the world's largest energy companies, with approximately 22 million electric points of supply and 2 million gas points of supply. For over 100 years, IBERDROLA has provided high-quality, environmentally friendly utility service.

IBERDROLA has received numerous awards for corporate excellence, leadership and achievement, including having been recognized in 2006 as Energy Company of the Year by Platts Global Energy Awards. IBERDROLA has also been named a leader in the Worldwide Utilities Category of the Dow Jones Sustainability Index, identified as one of the 50 best companies in climate strategy and listed in the Global 100 Most Sustainable Corporations in the World. In

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addition, IBERDROLA's Chairman and CEO, Ignacio Sanchez Galán, has been repeatedly recognized as a top energy executive. IBERDROLA's CFO, José Sáinz Armada, repeatedly has been named one of Europe's Best CFOs and IBERDROLA's Ignacio Cuenca has been recognized as Best Investor Relations Professional by Institutional Investor Research Group.

Energy East and Its Utility Subsidiaries Will Benefit From IBERDROLA's Commitment to Energy Efficiency and the Environment

Q. **Will IBERDROLA's commitment to energy efficiency and the environment provide any benefits to New York?**

A. Yes. As we described earlier in our testimony, sustainable development is the cornerstone of IBERDROLA's strategic plan, which is premised on using technologies that are cleaner, more efficient and environmentally friendly. IBERDROLA has demonstrated its commitment to renewable energy and the environment by developing world-class expertise in delivering sustainable, clean energy and its significant engineering and construction resources allow it to utilize new energy efficiency and environmental technologies.

Q. **Please explain how IBERDROLA's commitment to energy efficiency and the environment will benefit New York.**

A. IBERDROLA is committed to encouraging Energy East's efforts to implement energy efficiency initiatives and to invest in new utility technology. IBERDROLA has a strong commitment to demand side management and other conservation efforts, such as NYSEG's and RG&E's Advanced Metering

Infrastructure plan. In addition, New York will benefit from certain current IBERDROLA practices. For example, IBERDROLA: (1) distributes guides for energy efficiency to more than 1.5 million customers; (2) promotes energy efficient and electronically regulated air conditioning and heating devices; (3) provides advice on energy conservation and efficiency, printed on the back of the bill and forwarded to more than 9 million customers; (4) utilizes time-differentiated rates; and (5) supports industrial customers and government entities through energy audits to help them to achieve a better energy efficiency. Energy East, NYSEG and RG&E will benefit from IBERDROLA's experience regarding the implementation of renewable energy and environmental programs.

Q. In what other ways will Energy East benefit from IBERDROLA's environmental focus?

A. IBERDROLA has implemented an Environmental Policy, which includes Basic Action Principles that allow it to attain the most demanding objectives of European environmental policy. IBERDROLA also has established Ten Guidelines for Corporate Responsibility.

In addition, the Joint Petitioners also commit to having NYSEG and RG&E cooperate with the newly formed Climate Change Office in the New York State Department of Environmental Conservation, which will oversee implementation of the Regional Greenhouse Gas Initiative. IBERDROLA will bring an invaluable global as well as a regional and local perspective to these critical environmental issues.

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Q. Is IBERDROLA's commitment to the environment consistent with New York's stated policies?

A. Yes, IBERDROLA's commitments to energy efficiency, demand side management and other conservation efforts are consistent with Governor Spitzer's proposal to reduce demand for power by 15 percent from forecasted levels by 2015 (*i.e.*, the "15 by 15" energy policy). As a global leader in environmentally friendly programs, IBERDROLA also understands that renewable energy and environmental efficiency are two of the best ways to reduce dependence on fossil energy and to fight global warming. IBERDROLA is committed to facilitating Energy East's efforts to implement energy efficiency initiatives and to invest in new technology. IBERDROLA's commitment to programs that reduce customer demand in general and peak consumption in particular, a key goal of the State of New York's energy policy, make it a unique and valuable partner to assist NYSEG and RG&E in their development and implementation of environmentally friendly policies and initiatives.

Q. Are there any other aspects of IBERDROLA's environmental focus that would provide benefits to New York?

A. Yes. As part of IBERDOLA's commitment to the environment, IBERDROLA is the largest producer of wind energy in the world, with over 6,800 MW of wind capacity. In 2006 alone, IBERDROLA invested over $1.32 billion in renewable technologies and has over 40,000 MW of new renewable resources in the pipeline, including over 20,000 MW in the United States. IBERDROLA would be willing to explore how its expertise, capacity and resources to develop renewable generation could assist the State in meeting its energy goals. IBERDROLA's strategic plans are, therefore, consistent with the State's energy policies.

A. **The Proposed Transaction Allows NYSEG and RG&E to be Part of a Financially Strong Company System**

Q. Please describe IBERDROLA's financial strength.

A. IBERDROLA is one of the largest energy companies in the world. It currently has a market capitalization approximately $70 billion. Standard and Poor's has awarded IBERDROLA an "A" level rating for its long-term credit, thus recognizing IBERDROLA's strength and the stability of its financial results. IBERDROLA's financial strength was demonstrated following the announcement of the Proposed Transaction, when IBERDROLA issued 85 million new shares of common stock through an accelerated private placement that was fully subscribed. Thus, the capital markets have already provided IBERDROLA with approximately $4.5 billion for the Proposed Transaction and demonstrated IBERDROLA's capacity and ability to raise financial resources.

Q. Will IBERDROLA's financially strong position provide any additional benefits to Energy East?

A. Yes. The Proposed Transaction will provide Energy East (and thus RG&E and NYSEG) with greater access to both U.S. and global financial markets than they would have in the absence of the Proposed Transaction. IBERDROLA's ability to quickly sell 85 million new shares of common stock through a fully-subscribed accelerated private placement shows how access to capital can be a benefit of IBERDROLA's financial strength. By providing enhanced access to capital, the Proposed Transaction will allow NYSEG and RG&E to continue to provide high-quality, safe and reliable service.

B. <u>IBERDROLA is Committed to Excellence in Customer Service and Reliability</u>

Q. What impact will the Proposed Transaction have on customer service and reliability?

A. IBERDROLA has demonstrated through its global operations its competence and commitment in providing high-quality service and ensuring the delivery of safe and reliable energy supply. IBERDROLA understands the need to invest in infrastructure to support the goal of enhanced reliability. From 2005 to the end of 2007, IBERDROLA will have made capital investments of approximately $4 billion in transmission and distribution facilities globally, demonstrating its commitment to investing in improvements that promote a secure and reliable energy infrastructure.

IBERDROLA has maintained its focus on improving service quality for its approximately 22 million electric points of supply and 2 million gas points of supply around the world through development and improvement of its energy infrastructure. For example, with respect to standard measures of service interruption, IBERDROLA's focus on operational excellence is evident in its superior performance as measured by the Customer Average Interruption Duration Index ("CAIDI") and the System Average Interruption Frequency Index ("SAIFI"). Relative to U.S. benchmarks, IBERDROLA over the last 3 years has delivered results that would rank in either the first or second quartile of U.S. utilities. IBERDROLA's CAIDI of 1.70 hours for operations in Spain and the United Kingdom would rank near the top of the second quartile. The SAIFI performance of 1.16 average interruptions for operations in Spain and the United Kingdom is in the first quartile performance of U.S. utilities.

Q. Will the Proposed Transaction change NYSEG's or RG&E's proposed infrastructure projects?

A. No. IBERDROLA seeks no changes to the planned transmission and distribution improvements being undertaken by NYSEG and RG&E. With respect to new infrastructure projects, the Proposed Transaction will provide NYSEG and RG&E with additional financial stability and a greater ability to access to capital.

C. **<u>The Proposed Transaction Will Have No Adverse Impact on New York Ratepayers</u>**

Q. Are the Joint Petitioners making commitments regarding the recovery of transaction costs and the acquisition premium associated with the Proposed Transaction?

A. Yes. The Joint Petitioners commit not to seek recovery of costs incurred to consummate the Proposed Transaction from New York ratepayers. In addition, the premium paid for Energy East common stock resulting from the Proposed

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Transaction will remain on the books of IBERDROLA and its wholly-owned affiliates, and will not be recorded on the books of any of the companies acquired, including Energy East, RGS, RG&E, and NYSEG. To be clear, the Joint Petitioners will not seek recovery of any acquisition premium associated with the Proposed Transaction in rates from New York ratepayers.

Q. **Will the Proposed Transaction have any impact on the regulatory cost accounting and allocation methods that NYSEG and RG&E currently use?**

A. No. There are no plans to modify the existing regulatory cost accounting and allocation methods and reporting system utilized today for NYSEG and RG&E.

Q. **Will the Proposed Transaction impair access by the New York State Department of Public Service Staff to the books and records of NYSEG and RG&E?**

A. No. Neither the location of, nor Staff's access to, the books and records of NYSEG and RG&E will change in connection with the Proposed Transaction.

Q. **Are there any anticipated changes to rates or services provided to customers as a result of the Proposed Transaction?**

A. No. The Petitioners are not seeking to modify the existing rate plans of NYSEG and RG&E as part of the Proposed Transaction. Customers will also continue to be able to interact with their respective utility at its existing corporate headquarters and operations centers, the locations of which will not change in connection with the Proposed Transaction. In addition, no utility company operations, plant, equipment, franchises, permits, or other assets of RG&E or

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NYSEG will change or be transferred in connection with the Proposed Transaction. No restructuring that could result in any transfer of franchises, assets or permits would occur without first seeking any necessary Commission approval under Section 70.

Q. **Will the Proposed Transaction adversely impact New York communities?**

A. IBERDROLA is committed to the local communities it serves. IBERDROLA will not seek any reductions in any community activities, charitable benefits or other initiatives in which RG&E and NYSEG are currently involved.

D. **<u>The Proposed Transaction Will Not Enhance the Ability to Exercise Market Power in New York</u>**

Q. **Will the Proposed Transaction have any adverse impact with respect to the exercise of market power in New York?**

A. No. As demonstrated in the affidavit of William H. Hieronymus that is attached to the Joint Petition and that was submitted to FERC in connection with the Proposed Transaction, the Proposed Transaction will have no adverse impact with respect to market power in New York. As Dr. Hieronymus explains, the Joint Petitioners' combined share of NYISO installed capacity is well below 5 percent, and the combination of these shares clearly has an immaterial effect on market concentration.

Q. **Does this complete your direct testimony at this time?**

A. Yes, it does.

MR. FITZGERALD: Let the record reflect that a copy is being provided to the Judge and to the reporter.

Q. And did you have, panel, any exhibits to your direct testimony of benefits, particularly Exhibits 1 through 3 and 5 through 10?

A. (Mr. Rude) Yes.

A. (Mr. Laurito) Yes.

A. (Mr. Azagra) Yes.

Q. Were those exhibits prepared by you, under your direction or supervision?

A. (Mr. Rude) Yes.

A. (Mr. Laurito) Yes.

A. (Mr. Azagra) Yes.

MR. FITZGERALD: Your Honor, because the exhibits were attached to the Joint Petition that was filed, we would ask, for efficiency, that we would mark those as a single exhibit.

JUDGE EPSTEIN: Yes. Actually, I think what we should do, if I'm understanding you correctly, is take the entire Joint Petition as well as the 19 Tabs that were attached to it and mark it as Number 41.

MR. FITZGERALD: We have no objection to that, your Honor.

JUDGE EPSTEIN: Okay. Do you have a copy of that for the reporter?

MR. FITZGERALD: Yes, your Honor, we do.

JUDGE EPSTEIN: Okay.

MR. FITZGERALD: Your Honor, while that's being provided, may I continue with the panel?

JUDGE EPSTEIN: Yes.

MR. FITZGERALD: Thank you.

Q. Panel, do you have before you the 78-page document --

(Interruption of proceeding.)

(Exhibit Number 41 one was marked for identification.)

BY MR. FITZGERALD:

Q. Panel, I think that we were blocked by some noise. I'll start over with that again. Do you have a 78-page document, question and answer format, entitled, "The Rebuttal Testimony, Joint Petitioners' Policy Panel," dated January 31, 2008?

A. (Mr. Laurito) Yes.

A. (Mr. Rude) Yes.

A. (Mr. Azagra) Yes.

Q. Was that document prepared by you or under your direction?

A. (Mr. Laurito) Yes.

A. (Mr. Rude) Yes.

A. (Mr. Azagra) Yes.

Q. I understand you have some changes or corrections to your rebuttal testimony; is that correct?

A. (Mr. Azagra) Yes.

Q. Mr. Azagra, could you read those into the record for us today?

A. On page 7, line 21, after the words "credit ratings," we should include or insert "as compared to Energy East." And in line 23 of the same page, we should delete the words "with an" and insert instead "given Energy East's." And we should add an S at the end of the word "rating." In page 10, line 5, we should add a P as in pole after what it says, and we are missing the P of the Standard & Poor's. The P in Poor's is missing there. On page 49, line 6, we should delete the word "cost" and insert the word "cash." And that's all.

Q. Thank you.

JUDGE EPSTEIN: Mr. FitzGerald, I'm sorry. I need a copy of the rebuttal, if you have it.

MR. FITZGERALD: Certainly, your Honor. Let the record reflect that a corrected copy of the Joint Petitioners' Policy Panel rebuttal testimony was provided to the reporter and to the Judge.

Q. Panel, if I were to ask you the questions set forth in your rebuttal testimony, would your answers be the same as set forth in your testimony as corrected?

A. (Mr. Laurito) Yes.

A. (Mr. Rude) Yes.

A. (Mr. Azagra) Yes.

Q. Do you adopt this testimony as your sworn rebuttal testimony in this proceeding?

A. (Mr. Laurito) Yes.

A. (Mr. Rude) Yes.

A. (Mr. Azagra) Yes.

MR. FITZGERALD: Your Honor, may we have the rebuttal testimony as Joint Petitioners' Policy Panel as corrected copied into the record as if given orally?

JUDGE EPSTEIN: Yes.

(The following is the prefiled rebuttal testimony of the joint petitioners' policy panel:)

JOINT PETITIONERS' POLICY PANEL

I. INTRODUCTION

Q. Please state the names of the members of this Policy Panel for the record.

A. Our names are Pedro Azagra Blazquez, James P. Laurito and Robert E. Rude.

Q. Are you the same Pedro Azagra Blazquez, James P. Laurito and Robert E. Rude who submitted Direct Testimony in this proceeding on August 1, 2007 (the "Joint Petitioners' Direct Testimony")?

A. Yes.

Q. Have your positions or business addresses changed since the Joint Petitioners' Direct Testimony was submitted?

A. No, they have not.

Q. What is the overall purpose of your testimony?

A. The purpose of this testimony is to respond to portions of the direct testimony of the Department of Public Service Staff ("Staff") Policy Panel ("Staff Policy Panel"), which is comprised of the testimony of Thomas A. D'Ambrosia, Patrick J. Barry, Maynard Bowman, Michael Salony and Stephen A. Berger. Other witnesses also rebut portions of the Staff Policy Panel on behalf of the Joint Petitioners, including Steven Fetter, William Hieronymus, Eugene Meehan, Jeff Makholm and the Rate Adjustment Panel. We refer to those witnesses as appropriate. In the time available since receipt of the Staff Policy Panel's 317 pages of testimony and an even greater volume of accompanying exhibits, we have attempted to be as thorough as time permits in our review of that proposed evidence for matters requiring response. It is possible, however, that one or more

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such matters may have escaped our notice. Accordingly, to the extent that a particular matter raised in the testimony or exhibits of the Staff Policy Panel is not expressly accepted or rebutted herein, any such matter is rejected by this Panel. In addition, we respond to testimony filed by various intervenors.

Q. Mr. Azagra, please identify those areas of testimony for which you have primary responsibility.

A. While we are collectively sponsoring this Panel testimony with respect to the proposed transaction, my primary areas of responsibility are issues relating to: (1) the benefits of the proposed transaction; (2) the matters raised by the Staff Policy Panel regarding the U.S. Production Tax Credit ("PTC"), Spanish tax issues, and alleged benefits to current employees, stakeholders and others; and (3) the reporting, financial and affiliate risks identified by the Staff Policy Panel. Both Mr. Rude and I address issues relating to (1) the consolidation of information technology ("IT") systems, and (2) goodwill. Mr. Rude and Mr. Laurito will address the remainder of the Panel's rebuttal to the testimony of the Staff Policy Panel and intervenors.

Q. Does the Panel testimony address Staff's responses to information requests submitted by the Joint Petitioners that are related to the Staff Policy Panel's direct testimony?

A. Yes. We have reviewed several such responses by Staff and have specifically addressed some of the responses in our rebuttal testimony. However, additional analysis will be required as there was insufficient time to complete our review of these responses in the time provided to submit this Panel testimony. We further note that in certain responses, Staff has indicated that it intends to revise certain exhibits and we reserve the right to modify this Panel testimony at hearing to address any changes to Staff's exhibits.

Q. Is this Panel sponsoring any exhibits?

A. Yes. Exhibit __ (JPP-1) contains a copy of the interrogatory responses and workpapers referenced in this Panel's testimony. Exhibit __ (JPP-2) is a transcript from former Chairwoman (and current Commissioner) Acampora's November 13, 2007 remarks to Lehman Brothers. Exhibit __ (JPP-3) consists of an S&P report showing removal of "Watch Negative" and replacing it with a "Stable" outlook for Iberdrola, S.A. ("Iberdrola"). Exhibit __ (JPP-4) consists of a Moody's report showing "Stable" outlook and "A3" rating for Iberdrola. Exhibit __ (JPP-5) demonstrates that Iberdrola's gross and net operating profits were up well over 20% in the first nine months of 2007 as compared to the same period of the previous year. Exhibit __ (JPP-6) includes a stock price comparison. Exhibit __ (JPP-7) is a U.S. Securities and Exchange Commission ("SEC") issuance regarding financial reporting requirements. Exhibit __ (JPP-8) is the Synergy Appendix A from the Joint Proposal in Case No. 01-M-0404 – Energy East/RGS Merger.

II. EXECUTIVE SUMMARY

Q. Please summarize your testimony.

A. The acquisition of Energy East Corporation ("Energy East") by Iberdrola ("Proposed Transaction") presents New York with a unique opportunity to

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advance the State's energy and economic development policies. Iberdrola not only possesses immense financial strength (including credit ratings significantly higher than that of Energy East) but also global utility expertise, a demonstrated commitment to service quality, sustainable development and infrastructure investment, and expertise as the largest producer of renewable wind energy in the world. These attributes uniquely position Iberdrola to assist the State in meeting its Renewable Portfolio Standard and the Governor's "15 by 15" clean energy goal. Consummation of the Proposed Transaction will benefit New York by advancing the State's renewable energy policies, a fact recognized by several intervenors. In addition, the Proposed Transaction supports economic development by maintaining existing utility jobs in upstate New York while ensuring that New York ratepayers will bear none of the costs associated with the Proposed Transaction.

Despite the benefits of the Proposed Transaction and a lack of public opposition, Staff treats the Proposed Transaction as if it were a repeat of the National Grid/KeySpan merger. As explained by the Rebuttal Testimony of Mr. Meehan in further detail, the Proposed Transaction is significantly different than many of the transactions that have been presented to the Commission, including the National Grid/KeySpan merger. Rather, in many important respects, the Proposed Transaction is similar to certain other "first mover" transactions in the State. A comparison of the Iberdrola/Energy East merger to transactions that involved a combination of operating companies or other potential synergies, is therefore inappropriate. As Dr. Makholm explains in his testimony, Staff also

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mischaracterizes the Proposed Transaction as it relates to the public interest standard in New York.

Staff inappropriately seeks to modify existing rate plans and orders in this Section 70 merger proceeding. This proceeding should not be turned into a rate case, and Staff's rate case issues are more appropriately addressed in a subsequent rate proceeding designed to deal with those matters. As discussed in detail in the Rate Adjustment Panel testimony, Staff's proposal to impose onerous conditions on the Proposed Transaction, including write-offs, reserve increases, earnings sharing changes, and rate plan modifications, is inequitable and inadvisable, particularly in light of the many and substantial positive impacts of the Proposed Transaction on NYSEG and RG&E customers and the State as a whole. Staff's proposed rate plan modifications are inappropriate and, in the event they are nonetheless deemed relevant to the proceeding, they suffer from serious flaws. While the Joint Petitioners' Rate Adjustment Panel rebuts Staff's calculations regarding various Proposed adjustments to rates, the focus of this proceeding is and must remain on the Proposed Transaction, not on issues that should be raised, if at all, by Staff in future rate proceedings.

Staff also alleges various theoretical risks and speculates about potential harms, including imagined vertical market power concerns and a non-existent negative reaction by the credit rating agencies to the merger. Dr. Hieronymus testifies that the Proposed Transaction does not raise vertical or horizontal market power concerns. Dr. Makholm and Mr. Fetter demonstrate that Staff's concerns about credit quality are misplaced.

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At their core, Staff's positions themselves do not appear to be consistent with the public interest. They reflect a strong aversion to large holding companies and the emerging global nature of the utility business (in particular, gas and electric utilities), despite the fact that a number of New York utilities already are owned by non-U.S. entities. Staff's concerns are not shared by other governmental and regulatory bodies that have jurisdiction over the Proposed Transaction, including other states and federal agencies that have approved the Proposed Transaction (Connecticut, Maine, New Hampshire, and the Federal Energy Regulatory Commission) and other New York State and public interest organizations that have intervened in this proceeding (*e.g.*, New York State Department of Environmental Conservation, Empire State Development, Greater Rochester Enterprise, and the Natural Resources Defense Council).

III. BENEFITS OF THE PROPOSED TRANSACTION

Q. Mr. Azagra, the testimony submitted by Staff, as well as certain other intervenors in this proceeding, suggests there are no benefits associated with the Proposed Transaction (*see, e.g.*, Staff Policy Panel at 16-17). Can you summarize the benefits New York customers will realize from the Proposed Transaction?

A. As I explained in the Joint Petitioners' Direct Testimony, it is true that the Proposed Transaction does not provide immediate, measurable benefits in the form of merger synergies because the Proposed Transaction is an upstream transfer of control rather than a consolidation of operating companies. Since Iberdrola does not have any other regulated utility interests in the region or

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elsewhere in the U.S. (*i.e.*, this is a "first mover" transaction), the Proposed Transaction is not anticipated to result in any tangible and quantifiable synergistic benefits.

Q. Although the Proposed Transaction will not result in any synergy savings, will the Proposed Transaction nonetheless provide benefits to the State of New York?

A. Yes. The Proposed Transaction will benefit customers of NYSEG and RG&E, as well as the economy of the State of New York, in several important respects. These benefits are sufficient to satisfy the public interest standard, in particular given that the Proposed Transaction does not raise any of the potential risks that the Commission has been faced with in other transactions. Specifically:

- <u>Financial Stability</u> – Customers of NYSEG and RG&E will benefit from Iberdrola's financial stability. Iberdrola's market capitalization is approximately $67 billion (utilizing a currency exchange rate of $1.35/Euro), and Iberdrola has long-term "A" category credit ratings that are and have been higher than the credit ratings of Energy East. NYSEG and RG&E will obtain the financial stability and other benefits associated with becoming subsidiaries of a well-capitalized, multi-national, widely diversified energy holding company with a higher credit rating. For example, assuming no changes in market conditions, it is likely that the borrowing costs for NYSEG and RG&E should be lower as subsidiaries of Iberdrola (with 1-3 notches higher "A" category credit ratings as compared to Energy East) than the borrowing costs would be if NYSEG and RG&E did not become affiliates of Iberdrola (~~with a~~ given Energy East's lower "BBB" level credit rating~~s~~). The financial

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strength and stability associated with NYSEG and RG&E becoming subsidiaries of an "A" category rated company and the associated benefits to New York customers are discussed further below.

- Global Energy Experience and Best Practices – Customers of NYSEG and RG&E will benefit from Iberdrola's extensive global utility expertise, which the Commission has recognized as a benefit in water utility "first mover" transactions within the State. Iberdrola has been in the utility business for 100 years and is a world leader with high-quality, reliable and environmentally friendly electric distribution service to 22 million electric points of supply and 2 million gas points of supply in Europe and the Americas. Iberdrola is committed to sharing information about best practices among its operating utility subsidiaries, including NYSEG and RG&E. As discussed further below, such sharing of information has produced benefits for other utility subsidiaries acquired by Iberdrola.
- Focus on Renewable Development and the Environment – Customers of NYSEG and RG&E, as well as the State of New York, will benefit from Iberdrola's significant presence in New York because of Iberdrola's corporate philosophy, which incorporates a significant focus on energy efficiency, clean technology and the environment. Iberdrola is the world's leading producer of electricity from wind energy, with approximately 7,000 MW of wind capacity installed, and nearly 50% of Iberdrola's approximately 41,000 MW of total installed capacity is emissions-free. A number of states in the U.S. recognize the environmental benefits of

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renewable resources as well as the economic benefits that communities derive from the development of such resources, and there is competition among the states in terms of attracting investment in wind projects within their borders. Iberdrola is willing to work with the State of New York to further the State's renewable energy goals, including meeting its aggressive RPS goals. Iberdrola has substantial expertise, capacity and resources at its disposal, and is uniquely positioned to assist the State in meeting these goals.

- Economic Development and Jobs – The Proposed Transaction will reinforce ongoing efforts to maintain and revitalize the economy of upstate New York. While many horizontal utility mergers and acquisitions eliminate jobs, the Proposed Transaction includes no job reduction proposal, which helps to sustain economic development in the State of New York. Moreover, under the Agreement and Plan of Merger between Iberdrola and Energy East, employee compensation and benefits will remain substantially unchanged for a period of at least 18 months after the Proposed Transaction becomes effective. These aspects of the Proposed Transaction should be viewed as providing benefits to upstate New York.

A. Benefits of Iberdrola's Financial Strength

Q. Mr. Azagra, please explain how Iberdrola's financial strength can be expected to benefit customers of NYSEG and RG&E.

A. Customers of NYSEG and RG&E should realize a variety of benefits from the Proposed Transaction because Iberdrola is a larger, stronger holding company

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than Energy East. As I have previously explained, Iberdrola is a $67 billion company and is currently rated "A3" by Moody's and "A-" by S&P, both with stable outlooks. Iberdrola is currently rated "A" by Fitch with a negative outlook. By contrast, Energy East is rated "BBB" by Fitch, "Baa2" by Moody's and "BBB+" by S&P, all with negative outlooks. The Proposed Transaction should provide NYSEG and RG&E with greater access to capital at a lower cost than they would have on a stand-alone basis as subsidiaries of Energy East, thereby allowing NYSEG and RG&E to continue providing high-quality, safe, and reliable service.

As I explained in the Joint Petitioners' Direct Testimony, Iberdrola's successful issuance of $4.5 billion of equity to fund the acquisition of Energy East is a good example of Iberdrola's level of access to the capital markets. Iberdrola's issuance of equity to fund the Proposed Transaction protects ratepayers from the risks of debt financing utilized in other transactions, such as the risks that former Chairwoman (and current Commissioner) Acampora recently explained accompanied the financing of the National Grid/KeySpan merger (*e.g.*, negative credit rating differential and use of debt financing). *See* Exhibit __ (JPP-2). From the perspective of stable commercial dealings and cost of credit, it will be more favorable for NYSEG and RG&E to be subsidiaries of Iberdrola than Energy East (which has a lower credit rating and a negative outlook from all three ratings agencies, as compared to Iberdrola).

Q. The Staff Policy Panel has suggested that Iberdrola's financial strength "is of no consequence to the New York utilities" (at 62). Can you describe more

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specifically the benefits to NYSEG and RG&E that could be realized due to Iberdrola's higher credit ratings?

A. The credit rating of a parent company can affect the credit rating of its subsidiaries. Therefore, while it is not possible to quantify with precision the direct benefits associated with Iberdrola's stronger credit rating, it is reasonable to assume that the cost of debt capital for NYSEG and RG&E should be lower if they are subsidiaries of Iberdrola given that Iberdrola maintains a stronger credit rating than Energy East. For example, it is my understanding that S&P has a consolidated ratings approach. As such, the ratings for NYSEG and RG&E are currently linked to those of Energy East. Correspondingly, after the Proposed Transaction occurs, S&P may also consolidate Energy East's rating with that of its new parent, Iberdrola, thereby also enhancing the view of NYSEG and RG&E by the applicable credit rating agencies, and providing even greater financial stability to NYSEG and RG&E. There are generally known basis point spreads associated with different credit ratings, and, over time, the differential between Iberdrola and Energy East's credit ratings may translate into measurable cost savings for NYSEG and RG&E's respective regulated services, assuming other factors remain constant. The differential between Iberdrola's and Energy East's respective credit ratings could result in a measurable reduction in NYSEG's and RG&E's capital costs, and thereby provide a direct benefit to their ratepayers.

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Q. What impacts do the recent events in the global capital markets have on your conclusion that Iberdrola's higher credit rating will provide benefits to NYSEG and RG&E?

A. These recent events make it even more difficult for lower-rated companies, such as Energy East, NYSEG and RG&E, to raise debt and equity on favorable terms. Iberdrola's stronger "A" category credit ratings is therefore even more significant in terms of providing superior access to the capital markets. This is demonstrated by the increase in average basis point spreads on bonds for "BBB" rated utility companies to approximately 205 basis points from 103 basis points one year ago. The spread of "A" rated utilities has widened to a much lesser extent. Additionally, the difference in spreads between "A" and "BBB" rated companies has increased from 17 basis points to 35 basis points for the same period. Thus, today's volatile capital markets create an even greater opportunity for NYSEG and RG&E ratepayers to benefit from Iberdrola's stronger "A" category credit ratings.

Q. The Staff Policy Panel points out that Iberdrola was recently downgraded by S&P and Moody's (at 62). Can you address this issue?

A. Iberdrola was recently downgraded by S&P from "A" to "A-," and placed on negative watch pending the completion of the initial public offering of 20% of the equity of Iberdrola Renovables, S.A. ("Iberdrola Renewables"), a subsidiary of Iberdrola (the "Iberdrola Renewables IPO"). After the successful completion of the Iberdrola Renewables IPO, however, S&P removed the "Watch Negative" and replaced it with a "Stable" outlook for Iberdrola. *See* Exhibit __ (JPP- 3). The

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downgrade from "A2" to "A3" by Moody's was the result of Iberdrola's acquisition of ScottishPower, plc ("ScottishPower"), the Iberdrola Renewables IPO and Iberdrola's growth strategy. However, Moody's has made it clear that Iberdrola has a "Stable" outlook and that the "A3" rating is a forward-looking rating that already takes into consideration Iberdrola's Strategic Plan 2008-2010 (*see* IBER-0137S, Exhibit __ (JPP-1)) and the effect of the Proposed Transaction. *See* Exhibit __ (JPP-4).

Q. Are you concerned that there could be future downgrades of Iberdrola's credit rating to a "B" category rating?

A. No. The current ratings are forward-looking ratings and are either mid-level "A" category ratings with stable outlooks, or a mid-to-high level "A" category rating with a negative outlook. While there is no way of predicting future events that could impact Iberdrola's credit rating, Iberdrola is unquestionably committed to undertaking all reasonable efforts to maintain its current "A" category ratings. Quite simply, doing so is good for Iberdrola's business, and for its customers and shareholders.

The Staff Policy Panel apparently believes that there are a variety of factors, including concerns regarding the Proposed Transaction, that could lead to further downgrades (*see, e.g.*, at 151-58). I, and more importantly the capital markets, do not believe that this is probable. Iberdrola's most recent financial results demonstrate that it is on track to maintain its current, strong "A" category credit ratings. For example, in the first nine months of 2007, Iberdrola's gross and net operating profits were up well over 20% as compared to the same period

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of the previous year. *See* Exhibit __ (JPP-5). In addition, the equity markets have reacted favorably to Iberdrola's growth strategy. Iberdrola had a market capitalization of approximately €13 billion at the end of 2001. As of December 31, 2007, the market capitalization of Iberdrola reached €52 billion, making it the fifth largest utility in the world by that measure. A comparison of the stock prices of Iberdrola and Energy East from January 2004 through January 2008 illustrates that the equity markets have viewed Iberdrola, even after the close of the ScottishPower acquisition and the announcement of the Proposed Transaction, much more favorably than Energy East. *See* Exhibit __ (JPP-6). Additionally, I note that Staff has not identified any analyst report, communication or other document that has placed Iberdrola on credit watch for a downgrade other than for the one reason already resolved by the Iberdrola Renewables IPO. *See* IBER/EE IR No. 27, Exhibit __ (JPP-1).

Finally, there is no basis to presume that, even in the unlikely event that Iberdrola's credit ratings were downgraded, such downgrade would result in any direct harm to NYSEG or RG&E. Iberdrola's "A" category ratings are one to three notches above that of Energy East (rated "BBB"/"BBB+"). As such, even if Iberdrola were downgraded (which I believe to be improbable), there is no credible suggestion that Iberdrola's credit rating would fall below that of Energy East.

Q. Mr. Rude, the Staff Policy Panel alleges that S&P put NYSEG and RG&E "on watch for a downgrade" in part as a result of the announcement of the Proposed Transaction (at 167). Do you agree with Staff's suggestion that the Proposed

Transaction caused this negative outlook?

A. Absolutely not. As discussed in further detail in the Rebuttal Testimony of Mr. Fetter, the ratings agencies placed Energy East, NYSEG and RG&E on negative outlook in September 2006, shortly after the Commission issued its August 2006 rate order in the NYSEG electric proceeding, and approximately 9 months prior to the announcement of the Proposed Transaction. Accordingly, NYSEG's and RG&E's negative outlooks are completely unrelated to the Proposed Transaction.

Q. Do you agree with the Staff Policy Panel's claim that the Proposed Transaction had a negative impact on NYSEG's recent financing (*e.g.*, at 175-176)?

A. No, I emphatically disagree. As discussed in further detail in the Rate Adjustment Panel, the 30 basis point differential that Staff noted between NYSEG's debt issuance and those of its peers was caused by several factors, including ratings differences in Staff's proxy group and the relative size and frequency of NYSEG offerings compared to the proxy group, and was wholly unrelated to the Proposed Transaction. For the reasons described above, I agree with Mr. Azagra that the Proposed Transaction offers significant opportunities for NYSEG and RG&E to benefit from Iberdrola's stronger, "A" category credit ratings.

B. <u>Iberdrola's Global Utility Expertise</u>

Q. Mr. Azagra, can you please explain how Iberdrola's expertise will benefit New York ratepayers?

A. As I discussed in the Joint Petitioners' Direct Testimony, Iberdrola has 100 years of experience in the utility business and is a world leader that provides high-quality, reliable and environmentally friendly distribution service to 22 million

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electric points of supply and 2 million gas points of supply in Europe and the Americas. Iberdrola is an innovative and diversified holder and manager of utility and other energy assets with a well-demonstrated commitment to infrastructure investment, service quality and sustainable development. As I noted in the Joint Petitioners' Direct Testimony, Iberdrola's focus on service quality and operational excellence is evident in its superior performance as measured by the Customer Average Interruption Index (CAIDI) and the System Average Interruption Frequency Index (SAIFI). Relative to U.S. benchmarks, Iberdrola over the last three years has delivered results that would rank in either the first or second quartile of U.S. utilities. Moreover, Iberdrola has always been committed to sharing information about best practices among its operating utility subsidiaries, and will do so with Energy East, NYSEG and RG&E. *See* IBER-0030, Exhibit __ (JPP-1). It is my understanding that the Commission has valued such global expertise in other utility mergers (*e.g.*, the Thames/Long Island Water Company merger).

Finally, the Joint Petitioners wish to emphasize that reliability, safety and customer service will remain top priorities for both NYSEG and RG&E after the consummation of the Proposed Transaction.

Q. The Staff Policy Panel has suggested that the Proposed Transaction will not benefit New York ratepayers because Iberdrola has stated it will continue to rely on Energy East's, NYSEG's and RG&E's existing management (*see, e.g.*, at 74). Can you respond?

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A. Iberdrola values Energy East's, NYSEG's and RG&E's local management, and anticipates enhancing this existing management with leading local and national professionals after the closing of the Proposed Transaction. Iberdrola's reliance on local management does not, however, mean that Iberdrola will not be able to help improve the operations of Energy East, NYSEG and RG&E for the benefit of their customers. Rather, Iberdrola will be in a position to share information regarding best practices. Indeed, while Iberdrola has traditionally relied on local management for the operations of other, non-Spanish entities that it has acquired, Iberdrola has nonetheless had a measurable and positive influence on these operations. For example, even though Iberdrola has continued to rely on local management for its utility subsidiaries in Brazil and Guatemala, local management at those utilities instituted various programs and upgrades as a result of Iberdrola's practice of sharing information about best practices among its operating subsidiaries.

C. Renewable Benefits

Q. Mr. Azagra, please explain Iberdrola's expertise in developing renewable resources, such as wind farms.

A. As I described in the Joint Petitioners' Direct Testimony, Iberdrola is the largest producer of wind energy in the world with 7,000 MW of wind capacity.[1] In 2006 alone, Iberdrola invested over $1.32 billion in renewable technologies and currently has over 41,000 MW of new renewable resources in the pipeline,

[1] Capacity numbers are as of September 30, 2007.

including over 21,000 MW in the United States.[2] With this expertise, Iberdrola is uniquely positioned to assist the State in meeting its renewable energy goals.

Q. What are the State's renewable energy goals?

A. It is my understanding, based on information on the Commission's website and other publicly-available information, that New York's 2002 State Energy Plan warned of the possible consequences of New York's heavy dependence on fossil fuel. Therefore, at the request of Governor Pataki and after a study period, the Commission on September 24, 2004 adopted an RPS. The RPS establishes the State's goal of increasing the proportion of renewable electricity used by New York consumers to at least 25% by 2013. The Commission designated the New York State Energy Research and Development Authority as the central procurement administrator of the State's RPS program. Under this program, the major investor-owned utilities collect revenues from ratepayers for the purpose of achieving a mandatory RPS target set at 24% of retail electricity consumption. The remaining 1% of the overall 25% goal comes from voluntary purchases made by retail customers. The Commission itself noted that the primary benefits expected from implementing the RPS Program were in (1) diversifying the generation resource mix to improve energy security and independence; (2) attracting the economic benefits from renewable resource generators, manufacturers, and installers to the state; and (3) improving New York's environment by reducing air emissions and other adverse environmental impacts of electricity generation. In addition to the State's RPS, Governor Spitzer

[2] Capacity numbers are as of September 30, 2007.

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announced the "15 x 15" clean energy strategy in April 2007 to reduce the State's electricity consumption by 15% from forecasted levels by 2015. As part of this strategy, Governor Spitzer recognized the need to phase out less secure and dirtier power plants, and outlined a plan to make New York an ideal environment for investment in renewable energy projects.

Q. Please respond to the Staff Policy Panel's argument (at 29) that, given Iberdrola's affiliated wind projects and development activities in New York, the Proposed Transaction would actually prevent the State from meeting its RPS goals.

A. The Staff Policy Panel's argument that the Proposed Transaction would prevent the State from meeting its RPS goals is not only counterintuitive, it is illogical. As I have described, given Iberdrola's expertise in the development of renewable resources, it is uniquely positioned to assist the State in meeting its renewable energy goals. The Staff Policy Panel's position is based entirely on the unsupported allegation that, if Energy East becomes affiliated with Iberdrola's affiliated wind projects, other wind developers will not invest in New York, despite all of the economic incentives for them to do so. In fact, Staff recognizes the very extensive wind projects already in the New York Independent System Operator ("NYISO") interconnection queue (*see* IBER/EE IR No. 1, Exhibit __ (JPP-1)), and the announcement of the Proposed Transaction does not appear to have had any impact on such activities.

Despite the Staff Policy Panel's stated concerns on this point, there has been no suggestion by Staff or any other party in this proceeding that any developer has in fact scaled back its projects or withdrawn from the State as a

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result of the Proposed Transaction. No wind developer has even intervened in this proceeding, much less suggested that Iberdrola's acquisition of Energy East would adversely impact wind development in New York. In fact, neither the Independent Power Producers of New York ("IPPNY") nor any generation developer has raised any concerns in this proceeding with respect to potential vertical market power issues associated with the operating and planned wind projects in New York owned by Iberdrola's affiliates. It is worth emphasizing that a number of parties in this proceeding that have direct interests in increasing wind development in New York State – including the New York State Department of Environmental Conservation, the Natural Resources Defense Council and the Greater Rochester Enterprise – are on record as stating that the Commission should treat Iberdrola's renewables expertise as a benefit when evaluating the Proposed Transaction. Dr. Hieronymus provides further support in his rebuttal testimony for the conclusion that the Proposed Transaction will have no adverse effect on wind development activities in New York. Finally, I note that in Iberdrola's extensive and global wind experience, it has not witnessed any adverse impact on the level of wind development activities in the regions where Iberdrola owns both transmission/distribution businesses and wind generation.

Q. Do you have any comments with respect to the Staff Policy Panel's conclusion that, given Iberdrola's wind development activities in New York, the Proposed Transaction will create the potential for the Joint Petitioners to exercise vertical market power (*see, e.g.*, at 124-25)?

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A. The Rebuttal Testimony of Dr. Hieronymus explains in detail why the Proposed Transaction does not raise any vertical market power concerns. I would also like to provide some comments with respect to the factual parts of this discussion. As an initial matter, in response to concerns raised by the Staff Policy Panel (at 45-46), I note that the existence of antitrust claims against Iberdrola's transmission/distribution subsidiaries in other parts of the world is not relevant to the Commission's review of the Proposed Transaction, much less suggestive of any potential vertical market power issues associated with the Proposed Transaction. In fact, Staff admits that it has not compared the number of claims against Iberdrola with those of other domestic or foreign public utilities or public utility holding companies. *See* IBER/EE IR No. 12, Exhibit __ (JPP-1).

Q. Do you agree with the Staff Policy Panel's recommendation that, if the Commission approves the Proposed Transaction, it should require the divestiture of Iberdrola's affiliated wind projects in New York (at 288)?

A. Not at all. Dr. Hieronymus explains why Iberdrola's affiliated wind projects in New York could not be used in the exercise of vertical market power. I would like to add that the Staff Policy Panel's position on these projects does not make any sense in light of the State's aggressive renewable energy goals, and Iberdrola's ability to help the State meet those goals. Staff is the only party in this proceeding that is recommending the divestiture of these affiliated wind projects.

Q. Do you have any other comments on the Staff Policy Panel's recommendation that Iberdrola's affiliated wind projects in New York be divested as a condition to approval of the Proposed Transaction?

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A. The Staff Policy Panel believes that there is a contradiction inherent in Iberdrola's claim that it will be able to provide substantial benefits toward meeting the State's RPS targets, although its current operational and planned wind projects in New York are relatively *de minimis* (at 141-42). Staff fails to recognize that the State's renewable energy goals are very aggressive, and it is unlikely that those goals could be met through investment by a reduced number of developers. Rather, it is more likely that the State will need to rely on all available renewable developers to meet its goals. Given Iberdrola's expertise with the development of renewable projects, it is uniquely positioned to help the State meet those goals. Thus, the Commission should not discount the contribution that the Iberdrola group of companies could make to this effort.

Q. How is the Proposed Transaction related to meeting the State's renewable energy goals? Wouldn't Iberdrola and its affiliates continue to develop wind projects in New York regardless of the Proposed Transaction?

A. Certainly, the decision as to whether to develop a particular wind project is based on the economics of the project. That being said, a number of states in the U.S., in recognition of the environmental benefits of renewable resources as well as the economic benefits that communities derive from the development of such resources, are encouraging wind development activities within their borders. Iberdrola and its affiliates simply cannot invest in each state that is trying to attract renewable developers. Rather, renewable investment will be targeted to those states where there is a familiarity with the market opportunities, the RPS standards, and other applicable regulatory frameworks, as well as the general

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receptiveness within the state to such development. Logically, if Iberdrola has a significant presence in New York (such as through its affiliation with Energy East) and has made a positive determination with respect to these considerations in New York, then it and its affiliates may be more likely to target New York sites for additional wind development. I would also like to point out that, while there are a number of wind developers that are currently evaluating options in New York, Iberdrola's affiliates have a most impressive track record with respect to the completion of such projects. In fact, Iberdrola is one of only a handful of developers that has successfully completed and placed in service wind projects in New York. Any suggestion that Iberdrola and its affiliates should somehow be excluded from this effort is simply contrary to the State's renewable energy policies.

Q. Do you have any comments on the Staff Policy Panel's conclusion that Horizon and Gamesa should be included in any discussion of Iberdrola's wind development activities (at 129-30) and its suggestion that Iberdrola could influence the production and sale of wind generation equipment through its affiliation with Gamesa (at 142-43)?

A. The Staff Policy Panel misunderstands the nature of Iberdrola's limited relationships with Horizon and Wind Gamesa. Let me clarify this.

With respect to Horizon Wind, although Iberdrola holds a 9.5% equity interest in Energías de Portugal, S.A. ("EDP"), which holds a 70% ownership interest in Horizon Wind, Iberdrola may not exercise voting rights that represent more than 5% of EDP's voting share capital and does not have any seats on the

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EDP board. Iberdrola has no access to non-public information on Horizon Wind's development activities, and is not involved in the decision-making with respect to those activities.

With respect to Gamesa, Iberdrola holds an approximate 23.9% interest in Gamesa Corporación Tecnológica, S.A., a publicly-traded entity. However, there are structural protections in place to prevent Iberdrola and its affiliates from obtaining any competitive information on Gamesa's operations and, as such, the only information available to Iberdrola with respect to Gamesa's U.S. operations is information that is publicly available. In addition, there are structural protections in place to prevent Iberdrola from voting on matters related to Gamesa's development activities in the U.S. Thus, there is no commonality of control or access to non-public information as between the Iberdrola's affiliated projects, on the one hand, and the Gamesa or Horizon Wind projects, on the other.

Q. You mentioned earlier that IPPNY has not raised any concerns in this proceeding with respect to potential vertical market power issues associated with Iberdrola's currently operating and planned affiliated wind projects in New York. Do you have any comments on IPPNY's testimony in this proceeding?

A. Yes. While IPPNY does not recommend the divestiture of these projects, it does request (at 25) that the Commission require the Joint Applicants to "commit to not construct or otherwise acquire any ownership interests in other electric generating facilities located in RG&E's and NYSEG's respective service territories." I presume that what IPPNY is seeking here is a prohibition against the interconnection of affiliated generation projects to NYSEG or RG&E

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transmission facilities. Dr. Hieronymus explains in detail why such a commitment is simply not necessary.

Q. Do you have any suggestions as to how to address IPPNY's concern?

A. As Dr. Hieronymus describes in his testimony, the Commission already has certain regulatory oversight of the development and acquisition of generation in New York, including in the NYSEG and RG&E service territories. Additionally, neither NYSEG nor RG&E will develop additional utility-owned generation to be included in rate base unless authorized.

Q. The Staff Policy Panel expresses some concerns with the number of Iberdrola's U.S. affiliates and the use of Special Purpose Entities ("SPEs") for these businesses (at 216-18). Can you address this issue?

A. An SPE is a corporate entity, usually a limited liability company or a limited partnership, that is created to fulfill a specific objective, such as isolating financial risk, such as bankruptcy, taxation or regulatory risk. An SPE's debt is generally non-recourse, which means that, in the event of a default, the lender's recovery is limited to the collateral (typically the SPE's assets). Thus, by definition, the liabilities within Iberdrola's SPE subsidiaries would not flow upstream to Iberdrola or any of its affiliates. As such, the fact that many of Iberdrola's subsidiaries are structured as SPEs should be reassuring to the Commission, rather than a concern.

Moreover, all of Iberdrola's existing affiliates in the U.S. are unregulated entities involved in wholesale electricity generation and natural gas storage development and operation, as well as energy trading – and the use of SPEs is

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standard with respect to these types of businesses throughout the country. It is my understanding that virtually all, if not all, of the competitive wholesale generators located in New York are also structured as SPEs, which facilitates their use of traditional project financing structures. It is also my understanding that competitive wholesale generators that are affiliated with transmission owners in other states (such as FPL Energy, Constellation Energy, Duke, Exelon and many others) are often structured as SPEs. In fact, it would be unusual if individual energy project companies were financed and constructed without utilizing SPEs. These traditional structures are not complicated or unusual; rather, they reflect prudent practice for entities involved in the generation business.

Q. Can you address the Staff Policy Panel's concerns with respect to transactions between NYSEG and RG&E and their unregulated affiliates (at 222-23)?

A. Later in my testimony I will explain the specific structures that will be in place to govern these types of transactions and ensure that no affiliate abuse occurs. At this point, I would like to address the Staff Policy Panel's misstatements about the nature of the marketing contracts between Community Energy, Inc. ("CEI"), a partially-owned subsidiary of Iberdrola, and NYSEG and RG&E (at 230-32). These contracts were executed well before Iberdrola and Energy East began discussing a potential merger and, as such, represent arm's length transactions that were negotiated significantly before these entities had become affiliates. The affiliate rules that are already in place will help maintain the arm's-length nature of these contracts after the Proposed Transaction occurs. I would also like to point out that the Staff Policy Panel incorrectly states CEI sells power to NYSEG

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and RG&E customers under these agreements, and that NYSEG and RG&E are restricted from marketing any non-CEI energy to customers in their respective service territories. In fact, CEI only markets renewable energy certificates, and does not make any power sales under these contracts or otherwise.

D. Economic Development and Job Retention

Q. Mr. Azagra, the Staff Policy Panel states that the Proposed Transaction may cause, among other things, job losses (at 316). Does Iberdrola anticipate that the Proposed Transaction will result in any job losses?

A. No. In addition, Iberdrola has committed that existing employee compensation and benefits will remain substantially unchanged for a period of at least eighteen months after consummation of the Proposed Transaction.

Q. Why do you anticipate that the Proposed Transaction will not result in any job losses?

A. Typically, when a merger results in synergistic savings, a component of those savings stems from the elimination of jobs. By contrast, Iberdrola does not own any regulated utilities in the U.S., and therefore the Proposed Transaction does not involve the combination or elimination of corporate or utility operating functions, which are necessary to produce such savings (and often result in job losses).

Q. What impact will the Proposed Transaction have on the New York economy?

A. The Proposed Transaction will have a positive economic impact on the revitalization of the upstate New York economy, and this benefit is recognized by other parties to this proceeding. In particular, the Greater Rochester Enterprise

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notes that Iberdrola's position as a global energy leader will help upstate New York to compete on the global stage for jobs and investment, recruit new companies to the region, and provide the financial ability for continued investments in infrastructure (at 7-9). Additionally, Empire State Development states that potential investment in NYSEG and RG&E by a leading international energy company is a "key opportunity to assist the State in the implementation of upstate economic development objectives" (at 1). I agree with these parties that have acknowledged Iberdrola's positive impact on economic development in upstate New York as a benefit of the Proposed Transaction, and I believe that the State of New York would want to attract transactions of this nature.

IV. NO SYNERGIES/IMPUTED BENEFITS

Q. Does the Staff Policy Panel claim that the Proposed Transaction will result in any synergistic benefits?

A. Yes. The Staff Policy Panel claims that Iberdrola will obtain significant tax benefits as a result of the Proposed Transaction in the form of PTCs for wind energy projects, as well as Spanish tax credits (*see, e.g.*, 78-79). The Staff Policy Panel also suggests that there are synergy benefits related to IT consolidation (at 97) and certain alleged benefits to current employees, stakeholders and others resulting from the Proposed Transaction.

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Q. Does the Panel agree with the Staff Policy Panel's claim that these synergistic benefits exist?

A. No. The Joint Petitioners have not identified any synergistic benefits resulting from the Proposed Transaction. This is consistent with other "first mover" transactions, in which a non-U.S. entity undertakes its first acquisition of a regulated utility business in the U.S. While the Commission's treatment of synergy versus non-synergy transactions is discussed primarily in the Rebuttal Testimony of Mr. Meehan, it is the Joint Petitioners' understanding that the Commission has historically not required a sharing of imputed synergies in these "first mover" cases, because such cases do not result in any actual synergies or cost savings resulting from a combination of utility operations at the utility or holding company level. Thus, as the Proposed Transaction is a "first mover" transaction, the Joint Petitioners do not believe it would be appropriate for the Commission to impute synergies here. The Commission will have the opportunity to review any long-term benefits that may arise from the Proposed Transaction in future rate proceedings.

Moreover, although affiliates of Iberdrola have existing wind and thermal generation and gas storage businesses in the U.S., these unregulated entities are all owned by a separate parent company, Iberdrola Renewables, which is only 80% owned by Iberdrola and 20% publicly traded on the Spanish stock exchanges. These existing unregulated entities have a different business focus than Energy East and their day-to-day operations would continue to be separately managed after the consummation of the Proposed Transaction. Accordingly,

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Iberdrola's current U.S. affiliates do not offer any potential for synergistic savings with respect to Energy East, and Staff should not invent synergies that do not exist.

A. Production Tax Credits

Q. Mr. Azagra, what is Staff's argument with respect to PTCs?

A. Staff believes that Iberdrola does not pay enough U.S. income taxes to be able to utilize the full value of the PTCs associated with its affiliated wind projects and that, through the acquisition of Energy East, "it will acquire taxable income sufficient to enable it to utilize at least some and perhaps all of the PTCs that it has generated" (at 82). Staff estimates that Iberdrola could obtain up to $50 million of PTCs per year based on the existing level of its ownership interests in wind power facilities, assuming that each of these facilities qualifies for PTCs. Staff also estimates that if Iberdrola constructs all of its planned generation for 2007-2008, assuming that all of such projects are available for PTCs, it could generate up to $150 million in PTCs per year by 2008. Staff does not provide any basis for these estimates, other than very rough estimates that are based upon a calculation of Staff's estimate of 100% of the value of existing and future PTCs, regardless of how they are and would be otherwise utilized.

Q. For background, can you explain what PTCs are?

A. The PTC mechanism was created by federal legislation (the Energy Policy Act of 1992) as a subsidy to encourage power developers to expand renewable generation development in the U.S. The amount of the federal PTC for qualifying wind facilities is currently 2.0 cents per kWh of electricity produced in the U.S.

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from wind and sold to an unaffiliated third party. Because PTCs result in a reduction of U.S. federal tax liability, the entity (or consolidated tax group of entities) claiming such benefit must have sufficient offsetting U.S. federal tax liability in order to fully utilize the PTCs from affiliated wind projects. The PTC mechanism will expire at the end of 2008 (*i.e.*, 11 months from now), unless extended by Congress.

Q. Are there any synergistic PTC-related benefits resulting from the Proposed Transaction?

A. No. There simply are no PTC-related benefits of the Proposed Transaction. Let me start off by describing the ownership structure for Iberdrola's affiliated wind projects in the U.S. that have, or in the future may be, eligible for PTCs. Each of these projects is a wholly- or partially-owned, indirect subsidiary of Iberdrola Renewables, which, as I noted above, is owned 80% by Iberdrola, with the remaining shares traded on the Spanish stock exchanges. Any PTCs that may be available with respect to Iberdrola Renewables' wind projects in the U.S. are wholly unrelated to the Proposed Transaction: those PTCs exist regardless of whether the Proposed Transaction is consummated and regardless of Energy East's tax liability. In addition, PTCs associated with Iberdrola Renewables' operating wind projects have already been utilized sufficiently to develop and finance these existing projects. Furthermore, the availability of PTCs for any wind projects that Iberdrola Renewables may develop in the future is uncertain, and any such future PTCs would likely be utilized using investment structures similar to those in place for its wind projects that are already in operation.

Q. Can you explain why there are no PTC-related benefits resulting from the Proposed Transaction?

A. Yes. The PTCs associated with Iberdrola Renewables' wind projects have already been utilized by third-party equity investors sufficient to develop and finance these existing projects.

Q. Please explain what you mean when you say that these PTCs have been "utilized" by third-party equity investors.

A. Iberdrola Renewables' affiliates have entered into a number of structured institutional partnership investment transactions related to their operational wind farms. Under these so-called "tax equity" structures, a non-affiliated equity investor that is a partial owner of the project can utilize the PTCs to offset its own U.S. federal taxable income. These structures facilitate Iberdrola Renewables' wind growth beyond its own tax capacity.

Q. Can you explain how these "tax equity" structures work?

A. Assume for the sake of this discussion that a wind farm is an indirect, wholly-owned subsidiary of Iberdrola Renewables. Once that project becomes operational (or close to becoming operational), it is transferred to a holding company that is also an indirect, wholly-owned subsidiary of Iberdrola Renewables. A percentage of that holding company is then sold to an unaffiliated equity investor that has the capacity to utilize the project's PTCs to offset its tax liability. The investor makes an up-front cash payment and subsequent payments over time, based on the project's forecasted energy production. The tax benefits, along with the project's income and cash flows, are allocated to the investor and

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Iberdrola Renewables, disproportionately in favor of the investor. Once the investor has received an agreed-upon after-tax return or some other objective standard has been met, the sharing ratios may "flip" so that the investor would receive a smaller portion of the PTCs and income, and Iberdrola Renewables would receive a larger portion. Iberdrola Renewables, through its affiliates, maintains operational and management control over the project, and provides O&M services.

Q. Are these tax equity structures standard in the wind industry?

A. Yes, there is a strong demand for tax-advantaged investments in the U.S. market, and numerous entities in the financial community are involved in providing tax equity investment for renewable projects. Such investors include commercial banks, insurance companies and investment funds that are primarily interested in the available tax benefits, and not the long-term ownership of the wind projects. In fact, tax equity structures are so common in the wind industry that the U.S. Internal Revenue Service recently issued special rules for these structures.

Q. Will Iberdrola Renewables' subsidiaries be eligible for PTCs for wind farms that they may develop in the future?

A. Determining the availability of PTCs for future wind projects is a speculative exercise for a number of reasons. First, the completion of any wind development project depends upon a variety of development risks and other factors. As the completion and operation of development projects are not certain, the availability of any PTCs associated with those projects is also uncertain. Second, the availability of any PTCs for those future projects is uncertain given that the PTC

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mechanism is currently scheduled to expire on December 31, 2008. As I noted above, while we anticipate that Congress may extend the PTC mechanism beyond 2008, there is no guarantee that this will happen. Third, the amount of the PTC is based on the amount (in kWh) of electricity actually generated by a project. Given the intermittent and unpredictable nature of wind, the amount of PTCs available to any future project (assuming that the project is actually constructed is eligible for PTCs under a Congressional extension of the PTC mechanism) would also be uncertain.

Furthermore, the decision as to how to utilize any future PTCs that may become available will be made by Iberdrola Renewables, taking into consideration its tax liability and the tax liability of those entities with which it is consolidated for tax purposes.

Q. How important is the availability of PTCs for a particular development project?

A. The decision to develop a particular wind project is determined by the economics of that project, including the potential availability of any associated PTCs. In other words, the unavailability of PTCs would certainly have an adverse impact on Iberdrola Renewables' decision as to whether to invest in a particular development project. Again, I would like to emphasize that these PTCs are wholly unrelated to the Proposed Transaction or to the rates and operations of NYSEG and RG&E.

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Q. Do you believe that it would make for good public policy if the Commission were to find that the Proposed Transaction results in PTC-related synergistic benefits?

A. Absolutely not. As I described above, PTCs were created by federal legislation to put wind projects on a competitively level playing field with non-renewable generation resources and thereby encourage power developers to expand wind generation development in the U.S. Since the Energy Policy Act of 1992 was enacted, the PTC mechanism has been extended five times, with only two of these extensions occurring prior to the expiration of the then-current PTC provisions. The significance of the PTC mechanism as an incentive to the U.S. wind industry is demonstrated by the "boom and bust" cycles that it has experienced during those periods when the mechanism was allowed to lapse or its extension was uncertain. For a state regulator to effectively eliminate or even dilute this incentive, in particular in the context of a wholly-unrelated transaction, would clearly subvert the Congressional goal of encouraging the development of wind generation. The Rebuttal Testimony of Mr. Meehan also addresses this issue and explains that it would be improper as a policy matter for the Commission to interfere with the incentives provided by Congress for the development of renewable resources. The Rebuttal Testimony of Dr. Makholm further explains why any PTCs associated with Iberdrola's affiliated wind projects are not a relevant issue to ratepayers of NYSEG and RG&E.

Q. Do you have any comments on the Staff Policy Panel's specific calculations that Iberdrola could obtain up to $50 million of PTCs per year based on the existing

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level of its ownership interests in wind power facilities, and up to $150 million in PTCs per year by 2008?

A. The Staff Policy Panel doesn't provide any proper basis for its calculations. It appears that the Staff Policy Panel has simply provided an estimate of existing and future Iberdrola Renewables' wind capacity multiplied by 100% of the estimated PTC value. As explained above, because existing projects already have already utilized their PTCs, and because any PTCs for future projects are speculative at best, the expected value of PTCs to potentially offset against any Energy East tax liability should be zero.

B. Spanish Tax Benefits

Q. Mr. Azagra, the Staff Policy Panel has concluded that Iberdrola will receive certain tax benefits under Spanish law in connection with the Proposed Transaction and that these benefits should be treated as synergies in this proceeding (at 78-80). Please respond.

A. It would not be appropriate to consider these speculative Spanish tax "benefits" as synergies in this proceeding, because there is no certainty that Iberdrola will ever be able to obtain any tax offset or goodwill amortization associated with the Proposed Transaction under Spanish law. First, the Staff Policy Panel refers to Article 12(5) of the Spanish Corporate Income Tax Law (the "CIT Law"), which provides that financial goodwill related to the acquisition of shares in qualifying foreign subsidiaries may be amortized for tax purposes at a maximum yearly rate of 5% over 20 years. I note as an initial matter that Article 12(5) may operate as a tax deferral, rather than as a straight deduction. If and when an acquired company

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level of its ownership interests in wind power facilities, and up to $150 million in PTCs per year by 2008?

A. The Staff Policy Panel doesn't provide any proper basis for its calculations. It appears that the Staff Policy Panel has simply provided an estimate of existing and future Iberdrola Renewables' wind capacity multiplied by 100% of the estimated PTC value. As explained above, because existing projects already have already utilized their PTCs, and because any PTCs for future projects are speculative at best, the expected value of PTCs to potentially offset against any Energy East tax liability should be zero.

B. <u>Spanish Tax Benefits</u>

Q. Mr. Azagra, the Staff Policy Panel has concluded that Iberdrola will receive certain tax benefits under Spanish law in connection with the Proposed Transaction and that these benefits should be treated as synergies in this proceeding (at 78-80). Please respond.

A. It would not be appropriate to consider these speculative Spanish tax "benefits" as synergies in this proceeding, because there is no certainty that Iberdrola will ever be able to obtain any tax offset or goodwill amortization associated with the Proposed Transaction under Spanish law. First, the Staff Policy Panel refers to Article 12(5) of the Spanish Corporate Income Tax Law (the "CIT Law"), which provides that financial goodwill related to the acquisition of shares in qualifying foreign subsidiaries may be amortized for tax purposes at a maximum yearly rate of 5% over 20 years. I note as an initial matter that Article 12(5) may operate as a tax deferral, rather than as a straight deduction. If and when an acquired company

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is sold, the amount of the financial goodwill which has been amortized pursuant to Article 12(5) may be recaptured in the taxable base of the seller. Moreover, the amortization of goodwill pursuant to Article 12(5) is subject to significant legal restrictions imposed by tax authorities in Spain. In particular, recent rulings by these authorities have questioned whether the acquisition of a holding company (*i.e.*, where the top tier entity is not the operating utility company, as is the case with Energy East) may actually generate goodwill eligible for amortization. *See* IBER-0148, Exhibit __ (PP-2).

Q. Are there any other reasons why it is speculative to assume that Iberdrola will receive any tax benefit under Article 12(5) in connection with the Proposed Transaction?

A. Yes. For the reasons described above, it is uncertain whether any or all of the goodwill associated with the Proposed Transaction will be eligible for amortization under Article 12(5). By way of example, Iberdrola has not yet been able to determine whether any or all goodwill from its ScottishPower acquisition, which closed in April 2007, will be eligible for amortization under Article 12(5).

Q. Does the Staff Policy Panel identify any other potential tax benefits under the CIT Law?

A. Yes. The Staff Policy Panel also references Article 37 of the CIT Law (at 80), which provides a tax offset for companies purchasing shares in foreign companies to the extent the purchase leads to increased export activities. The European Competition Commission has declared offsets under Article 37 incompatible with the common market and requested that Spain gradually repeal Article 37 by 2010.

Additionally, the Spanish tax authorities have interpreted Article 37 as requiring a "direct and immediate relationship" between the investment (*i.e.*, the acquisition of a foreign entity by the Spanish company) and the export activities of the Spanish company before the offset can be utilized. Accordingly, it is uncertain whether Iberdrola will be eligible to obtain any tax offset under Article 37 of the CIT Law. *See* IBER-0147, Exhibit __ (PP-2). Additionally, as discussed in the Rebuttal Testimony of Mr. Meehan, it does not seem appropriate for the Commission to suggest that potential tax savings or deferrals offered by the Spanish government to holding companies should be treated as synergies of any proposed acquisition, including this Proposed Transaction. Finally, I note that the provisions of Article 12(5) and Article 37 of the CIT Law are mutually exclusive: the purchase price to which the deduction based on financial goodwill is applied under Article 12(5) is automatically ineligible for the tax offset provided under Article 37. For all of these reasons, Iberdrola did not consider any Spanish tax savings or deferral under Article 12(5) or 37 of the CIT Law in its valuation of the Proposed Transaction.

C. Benefits from IT Consolidation

Q. The Staff Policy Panel has taken the position that the Proposed Transaction could result in synergistic savings stemming from possible IT consolidation (at 97-98). Does the Panel anticipate any such savings?

A. No, and Iberdrola did not consider any savings from IT consolidation in evaluating the Proposed Transaction. As an initial matter, all ascertainable IT savings associated with Energy East were already realized beginning in 2002

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when it acquired the last of its various operating companies, RG&E, and ending in 2004 with the implementation of the SAP system to support financial and work management functions. In addition, there are currently no plans to consolidate IT operations among Energy East, NYSEG, RG&E and Iberdrola's unregulated generation and natural gas affiliates in the U.S. due to the significant challenges associated with combining the IT functions of regulated and non-regulated operations.

Q. Mr. Rude, did Energy East elect to consolidate its regulated and unregulated operations on a single IT platform when it engaged in its most recent IT consolidation?

A. No. Energy East made the decision in 2002 to create a new shared service organization to support just its regulated utility operating companies. Consolidating these IT functions in Rochester, New York, was part of the plan. Prior to this consolidation, each Energy East utility had its own IT department. Detailed planning and work supporting the IT consolidation began late in 2002 and continued through the end of 2005. IT consolidation was successful because the basic requirements the Energy East utilities have for IT services are relatively consistent across those utilities. This allows IT work processes to be standardized and leveraged across the utilities. It is unlikely that non-regulated entities would have the same IT service requirements as Energy East's regulated utility subsidiaries.

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Q. Mr. Rude, what were the main steps required for IT consolidation among Energy East's utilities?

A. One of the first steps in the IT consolidation effort was to define the new organization, develop new functional responsibilities, and develop a single set of processes to support multiple utilities. The majority of the organizational changes took effect in May 2003. The new organization included a centralized IT Help Desk, a centralized Network Operations Center, and a centralized Data Center. Additionally, the Network, Technical and IT Support Service teams were consolidated in Rochester, New York, where they standardized operations and worked under the direction of a single management team.

Q. What were the next steps for IT consolidation?

A. The second step was contract consolidation. The consolidated IT entity sought to re-bid and/or renegotiate several of its largest contracts with better pricing and terms. Over the consolidation period, new contracts were negotiated in the areas of telecommunications, mainframe hardware and software, disaster recovery and help desk services. The third step was technical consolidation. While the organizational changes were being made work was being done to consolidate the physical technology IT supports. Data Centers were consolidated to Rochester, resulting in data center closures in Hartford, Connecticut, Bridgeport, Connecticut, and Ithaca, New York. Additionally, the technology in the Augusta, Maine, data center was converted from a primary location to a back up location for the Rochester facility. A new network design was implemented to connect the Energy East utilities to one another and the Rochester Data Center. Additionally,

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network infrastructure standards were developed and implemented to reduce the complexity and cost of operating the network. A corporate desktop was developed to standardize the desktop operating systems, office productivity tools (*e.g.*, email, word processing, spreadsheets, etc), remote connectivity tools and collaboration tools. In the process, corporate PCs were refreshed and standardized in 2005.

Q. Please explain why the fourth step related to applications makes it difficult to obtain the type of synergies Staff alludes to in the combination of regulated and non-regulated entities.

A. IT Application consolidation was driven by the implementation of SAP. In 2004, Energy East implemented a suite of applications in SAP including, HR, Payroll, Finance, Accounting and Materials management. This allowed those areas of the business to consolidate under the shared service umbrella. Upon completion of the Back Office implementation, the utility-specific Application teams that supported those applications were consolidated onto a single central team. A similar process took place in 2005, when the work management applications at the Energy East utilities were replaced with SAP. After the SAP implementation, support for work management applications was consolidated on a central team. Each of these applications share considerable community of interest for regulated entities but would be markedly different for unregulated entities that require different services.

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Q. What were the guiding principles of the integration work undertaken by Energy East in the IT area?

A. The integration focus was limited to the regulated T&D businesses. These businesses were the common denominator for investments that fostered additional commonality that could yield material merger related synergies. Branching IT consolidation into other areas including unregulated activities would have diluted the returns for the integration efforts. In part this dilution would have occurred because of the unique nature of the regulated businesses versus all other businesses. The need to segregate regulated utility shared service company activities from unregulated subsidiary activities must also be recognized.

Q. Mr. Azagra, did any IT consolidation savings result from Iberdrola's acquisition of ScottishPower and, if so, why wouldn't Iberdrola anticipate similar savings with respect to Energy East?

A. Prior to Iberdrola's acquisition of ScottishPower, ScottishPower had a uniquely high IT cost base arising from the fact that it obtained its IT services from a large number of suppliers, at high costs and without disciplined procurement budgeting and control at a central level. There were approximately 400 service level agreements and over 400 applications being used in ScottishPower. In addition, ScottishPower had not moved to the industry standard SAP application. By contrast, as discussed above and as the Staff Policy Panel has acknowledged (at 97), Energy East's utility subsidiaries, including NYSEG and RG&E, already have implemented the SAP system. In addition, given the IT consolidation that has already occurred, Energy East and its subsidiaries do not have the same IT

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supplier management issues that were faced by ScottishPower. As such, a similar opportunity for IT consolidation savings does not exist with respect to the merger between Iberdrola and Energy East. For these same reasons, the Proposed Transaction will also not create any stranded costs with respect to NYSEG's and RG&E's SAP system, as the Staff Policy Panel suggests (at 97).

Additionally, the regulated T&D business represented only €3 million per annum of the announced expected synergies in Iberdrola's acquisition of ScottishPower. This amount was made up of some relatively limited expected savings in joint procurement of capital investments, and is consistent with the very limited nature of operational synergies in cross-border combinations involving a regulated T&D utility. Finally, I note that there has been no IT consolidation between ScottishPower's U.S. operations and Iberdrola's U.S. operations since Iberdrola's acquisition of ScottishPower last year.

Q. Is it likely that there could be synergies in combining United States and Spanish IT systems?

A. Iberdrola has not undertaken an evaluation of whether any cost savings could be achieved by integrating common IT platforms between Energy East and Iberdrola. *See* IBER-0095, Exhibit __ (PP-2). A variety of factors (including among other things, geographic separation, time-zone differences and accounting standards) would make such integration difficult, even to the extent that there were IT platforms in common between Energy East and Iberdrola.

Q. Please summarize the Panel's view of the potential IT integration synergies suggested by Staff.

A. The Panel believes that material IT synergies have already been achieved by the integration of the Energy East utilities' IT systems. Any alleged additional synergies created by seeking to integrate unregulated affiliates would be inconsistent with our efforts to avoid cross-subsidization between regulated and unregulated operations.

D. <u>Alleged "Benefits" To Current Employees, Stakeholders And Others</u>

Q. The Staff Policy Panel states that the Proposed Transaction will result in substantial benefits to Energy East shareholders, executives and other third parties (for example, investment bankers, advisors and attorneys) that should be shared with ratepayers (at 87-89). Can the Panel respond to this assertion?

A. This Staff argument is difficult to understand from a practical or logical perspective. These are costs to consummate a transaction that is in the best interests of the State. Put simply, the payments identified by the Staff Policy Panel are just the cost of doing business, and would be similarly incurred by any other potential acquirer of utilities in New York. In this case, these costs will have no effect on customers of NYSEG and RG&E. As the Panel has previously explained and as discussed in greater detail below, Iberdrola has committed that its shareholders will bear the costs of the Proposed Transaction and that NYSEG and RG&E will not seek recovery in rates of any such costs. To somehow claim that these transaction costs are "benefits" to anyone defies logic. As discussed in detail in the Rebuttal Testimony of Mr. Meehan, the Staff Policy Panel's assertion

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that these "benefits" should be shared with ratepayers would be a bad policy for the Commission to adopt as it attempts to impose additional costs on parties interested in investing in New York utilities without regard to whether such purposed "benefits" are attributable to effects on New York utility operations.

V. WRITE-OFFS, WRITE-DOWNS, RESERVES, AND RATE PLAN MODIFICATIONS

Q. Is the Panel generally addressing the Staff Policy Panel's and Staff's recommendations regarding write-offs, write-downs, reserves and rate plan modifications in your rebuttal testimony?

A. No. These topics are primarily being addressed in the Rate Adjustment Panel and the Rebuttal Testimony of Mr. Meehan. However, the Panel would like to address certain issues raised by the Staff Policy Panel with respect to goodwill.

Q. Does the Panel agree with Staff's definition of goodwill for regulatory purposes as "the excess of the purchase price over original cost"?

A. Yes. It provides a workable definition of goodwill in this context.

Q. What are the three categories of goodwill that are discussed by the Staff Policy Panel?

A. These three categories are the goodwill associated with the Energy East/RGS transaction ("RGS Goodwill"), the goodwill associated with Iberdrola's purchase of Energy East ("New Goodwill"), and existing goodwill on Iberdrola's books. While the Rebuttal Testimony of Dr. Makholm addresses the overall treatment of goodwill, this Panel will briefly address Staff's proposed treatment of these three

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categories of goodwill.

Q. Mr. Rude, was the transaction that resulted in the RGS Goodwill approved by the Commission?

A. Yes. In its *Order Adopting Provisions of Joint Proposal with Modifications*, issued February 27, 2002 in Cases 01-E-0359 and 01-M-0404, the Commission approved the merger that created the RGS Goodwill as in the public interest.

Q. Is the RGS Goodwill included on Energy East's books or on RG&E's books?

A. The RGS Goodwill resides on the books of RGS. The RGS Goodwill was not "pushed-down" to NYSEG or RG&E. The RGS Merger Joint Proposal approved by the Commission states that "the cost of such business combination {i.e. the merger] shall not be 'pushed' down below the New RGS level, and the goodwill created in this transaction shall not appear on the books of either RG&E or NYSEG." *See* Section III.G of the Energy East / RGS Merger Joint Proposal approved in Case 01-M-0404.

Q. Does the RGS Goodwill increase or decrease as a result of the Proposed Transaction?

A. Neither. The RGS Goodwill is not changed by the Proposed Transaction.

Q. Have New York ratepayers paid for the RGS acquisition premium?

A. No. The premium was not recovered from New York ratepayers.

Q. Staff notes that Iberdrola has made no commitments concerning the existing goodwill associated with the Energy East/RGS transaction that is currently recorded on Energy East's books. Is this correct?

A. Yes. The Joint Petitioners' have not proposed to take any steps with the pre-

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existing RGS Goodwill.

Q. How has Staff proposed to treat the RGS Goodwill?

A. The Staff Policy Panel recommends that Iberdrola remove the RGS Goodwill from Energy East's books (at 92-93).

Q. Do you support this recommendation?

A. No. First, the RGS Goodwill currently resides on the books of RGS, not Energy East. In any event, it would be unprecedented for an unregulated entity (in this case RGS or Energy East) to be required by the Commission to move goodwill upstream to another unregulated entity. The RGS Goodwill was placed on the books of RGS prior to the Proposed Transaction and is unrelated to and unaffected by the Proposed Transaction, and it would therefore be inappropriate to require Iberdrola to remove the RGS Goodwill from Energy East's books as a condition to the Proposed Transaction.

Q. What rationale, if any, does Staff offer to support its recommendation?

A. Staff states that "the acquisition of Energy East involves the purchase of Energy East's assets; among those assets is the goodwill on Energy East's books." Staff, however, mischaracterizes the nature of the Proposed Transaction, which involves the purchase of Energy East's stock and not its individual assets.

Q. Staff also argues that the "push up" of RGS Goodwill will improve financial transparency by avoiding the fact that existing goodwill has been a continuing source of controversy in the utilities' rate cases because it allegedly "clouds the true picture of Energy East's financial health." Do you agree with this argument?

A. No. The RGS Goodwill has not in any way "clouded" the picture of Energy

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East's financial health. The RGS goodwill is clearly recorded on RGS's books and is therefore clearly separate from RG&E's and NYSEG's books. In fact, even where goodwill is recorded on the books of other Energy East utility companies in other jurisdictions, no regulatory body with jurisdiction has struggled with transparency or alleged the existence of any "cloud." This concern is clearly without merit.

Q. What, if anything, should happen to the RGS Goodwill as a result of the Proposed Transaction?

A. Nothing should happen to the RGS Goodwill. It is unrelated to, and unaffected by, the Proposed Transaction and should therefore remain on the books of RGS. The placement of the RGS Goodwill on RGS' books was approved by the Commission when it approved the RGS transaction and Staff has failed to justify its unprecedented request to move goodwill from one unregulated holding company to another unregulated entity.

Q. Mr. Azagra, has the Staff Policy Panel raised any concerns regarding the goodwill on Iberdrola's books?

A. Yes. The Staff Policy Panel has raised a number of concerns regarding the amount of goodwill on the books of Iberdrola and the potential impairment of that goodwill. There is no basis for the Staff Policy Panel's concerns on this issue. As an initial matter, goodwill is not a primary indicator of the risk profile of a company, as described in further detail in the Rebuttal Testimony of Mr. Fetter, and the Staff has been unable to point to any credit report about Iberdrola that even mentions goodwill. *See* IBER/EE IR No. 51, Exhibit __ (JPP-1).

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Furthermore, the goodwill on Iberdrola's balance sheet is a result of historical transactions, and has been estimated based on the fair value of those historic transactions, based on the expected cash flows generated through each historic acquisition. Under both the International Financial Reporting Standards ("IFRS") and U.S. Generally Accepted Accounting Principles ("U.S. GAAP"), goodwill is recorded at a ~~cost~~ cash generating unit ("CGU") level. Thus, Iberdrola's goodwill only would be impaired if its expected future cash flows were no longer sufficient to support the amount of goodwill on a CGU level. Given Iberdrola's strong cash flow and earnings growth, and the high opinion of Iberdrola by the capital markets (as reflected in its ratings by the credit ratings agencies, and both its successful capital increase to finance the Proposed Transaction and the successful Iberdrola Renewables IPO) it is completely unrealistic and unfounded to assume that any significant portion, much less all, of the goodwill recorded across all of its various CGU levels could suddenly become impaired as suggested by the Staff Policy Panel. Finally, it is important to note that Iberdrola has consistently committed that no goodwill in connection with the Proposed Transaction will be recorded on the books of NYSEG or RG&E. The Rebuttal Testimony of Dr. Makholm explains that because Goodwill will not be pushed down to the books of Energy East, NYSEG or RG&E, it will have no affect on rates, or ratepayer interests.

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VI. REPORTING, FINANCIAL AND AFFILIATE RISKS IDENTIFIED BY THE STAFF POLICY PANEL

A. Diminished Transparency and Reporting

Q. Mr. Azagra, do you agree with the Staff Policy Panel's suggestion that the Proposed Transaction will result in diminished financial transparency and reporting?

A. No. The Staff Policy Panel states that "[d]ifferences in accounting standards and language, coupled with a complex organizational structure, and the unfamiliarity of Iberdrola with New York regulators and their policies all pose a risk for the customers of NYSEG and RG&E" (at 24-25). These risks are without foundation, and they unfairly disregard the track record of other stable and successful foreign utility investments in the United States. In particular, it is my understanding that there are a number of utilities within the State of New York that are successfully operated by foreign companies, including United Water, American Water, Niagara Mohawk and KeySpan.

Moreover, Iberdrola will continue to comply with all U.S. laws and regulations regarding financial reporting. As made clear by the SEC, both U.S. GAAP and the IFRS under which Iberdrola prepares and reports its financial statements are high-quality accounting standards that are similar to one another in many respects and rapidly converging. *See* Exhibit __ (JPP-7). Iberdrola also will make appropriate persons available to respond to specific inquiries regarding the differences in these two accounting standards. Additionally, Energy East will

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continue to use U.S. GAAP for all financial reporting and will comply with existing and any applicable requirements of the Sarbanes-Oxley Act.

Nonetheless, the Joint Petitioners wish to acknowledge the Staff Policy Panel's financial transparency and reporting concerns. While we believe that no further commitments are required here in order for this Proposed Transaction to be found to be in the public interest, the Joint Petitioners are willing to commit to the following additional financial transparency and reporting measures to further ensure that the Commission and the public will have robust access, in English and in New York, to the following information related to Iberdrola, Energy East, NYSEG, and RG&E:

- **Books & Records** - The Commission will have access, in English and in New York, to (1) the books/records of NYSEG and RG&E, and (2) any books/records of Iberdrola or any Iberdrola affiliates that are related to NYSEG or RG&E. The Commission will have access, in English and in New York, to any minutes of the Iberdrola Board of Directors, and any sub-committee thereof, to the extent that such minutes discuss Energy East, NYSEG or RG&E. Iberdrola also shall translate such other documents as the Commission determines to be reasonably necessary to fulfill its statutory duties.
- **Audit Reports** - The Commission will have access, in English and in New York, to all internal and external audit reports and recommendations for NYSEG and RG&E, and for any Iberdrola affiliate with respect to the provision of goods and services for compensation to NYSEG or RG&E.

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- **Financial Statements** - Iberdrola's consolidated balance sheets, income statements and cash flow statements will be made available to the Commission, in English and in New York, on an annual basis and in a format that is mutually agreed to between Iberdrola and the Commission Staff. Audited financial statements will be in accordance with IFRS as, as issued by the International Accounting Standards Board, consistent with SEC requirements. Additionally, Iberdrola agrees to provide specific answers to particular questions raised by the Commission and its Staff with respect to IFRS.

The commitments should adequately address any concerns regarding financial transparency and reporting issues.

Q. Mr. Azagra, do you believe that the translation of documents should be a major issue in connection with the Proposed Transaction?

A. No. As a global company with significant existing operations in the U.S. and the United Kingdom, and given its numerous U.S. investors, Iberdrola already translates key documents into English in the ordinary course of business. Indeed, a substantial amount of information, including all key financial information, is already routinely made available publicly in English on Iberdrola's website. Moreover, Iberdrola will need to communicate with Energy East, NYSEG and RG&E in English and documents related to the management of these entities will be prepared in and/or translated into English accordingly.

Additionally, the concerns raised by the Staff Policy Panel regarding the translation of documents in the Maine Public Utilities Commission's review of

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the Proposed Transaction (at 47) were based solely upon the onerous number of document translations requested by one party to that proceeding on issues that were unrelated to the Proposed Transaction and that proceeding. That party has subsequently signed a comprehensive settlement agreement that resolves all issues raised in that proceeding, including translation issues, and the Maine Commission has voted to approve that settlement. Iberdrola translated all documents requested by the Maine Advisory Staff in that proceeding. Thus, the Staff Policy Panel should not be concerned about translation issues in connection with the Proposed Transaction, particularly in light of the reporting commitments that I discussed above.

B. Data Security

Q. Mr. Azagra, do you agree with the Staff Policy Panel's data security concerns regarding vulnerabilities in the New York electric grid, as well as sensitive personal customer data, and "the possibility that this information could wind up in the wrong hands" after the Proposed Transaction (at 292)?

A. No. Iberdrola has put robust protections in place to protect its information systems against unwanted access, either by authorized or unauthorized personnel, with the aim of ensuring the confidentiality and integrity of the information processed by those systems. Access to Iberdrola's information systems from the outside may only be made through safe, encrypted channels. These measures apply to all office information systems, as well as to systems related to power production and gas and electric distribution. Iberdrola's information systems follow the most demanding practices in the world, including those in the United

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States. In fact, Iberdrola participates with other U.S. electrical utilities in the Electric Power Research Institute's Cybersecurity Assessment Program, which focuses on North American Electric Reliability Corporation security standards. Finally, I note that Iberdrola has no intention to merge its information control systems with those of Energy East.

Nonetheless, the Joint Petitioners want to acknowledge the Staff Policy Panel's data security concerns and are willing to commit to the following measures to ensure further that critical energy infrastructure information, as well as sensitive personal data of NYSEG and RG&E customers, remains secure:

- **Data Security** – The Joint Petitioners commit that information about vulnerabilities in the New York electric grid and the gas pipeline network, in all media formats, shall remain within the headquarters of NYSEG and RG&E. The Joint Petitioners also commit that customer data (*e.g.,* names, addresses, telephone numbers, social security numbers, credit reports) shall remain, in all media formats, within the headquarters or customer service centers of NYSEG and RG&E.

C. <u>Credit Quality Risks</u>

Q. Mr. Azagra, do you agree with the Staff Policy Panel's concerns about Iberdrola's financial status and credit downgrade?

A. No. The Staff Policy Panel incorrectly states that Iberdrola's capital investment program "has caused concern at the credit agencies" and that the credit agencies are also concerned "about the high degree of leverage Iberdrola plans to deploy and how its large investment program will be financed" (at 23). The Staff Policy

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Panel also suggests that declines in Iberdrola's credit quality could have a negative impact on the credit ratings of NYSEG and RG&E, as well as their ability to raise capital. As described more fully in the Rebuttal Testimony of Mr. Fetter, these concerns have no foundation. As the third largest "investor-owned" utility in Europe with an impeccable track record and stable "A" category credit ratings, Iberdrola's access to the capital markets at terms and pricing that are consistent with its "A" category credit ratings is not in question. Additionally, Iberdrola's current strong "A" category credit ratings already take into account Iberdrola's capital structure and its future investment program, including the information described in Iberdrola's Strategic Plan 2008-2010.

The Proposed Transaction does not raise any of the credit issues raised in the National Grid/KeySpan transaction, in which the parent company had a lower credit rating than the target utility and utilized significant debt to finance the transaction. As a result of that transaction, KeySpan's standalone "A" rating fell to National Grid's lower "A-" rating. If the Proposed Transaction were to have a similar impact, then Energy East's credit rating would actually improve 1-2 notches, which would amount to a substantial improvement in its credit quality.

Finally, the Joint Petitioners are willing to commit to the following credit quality measures to ensure further that this Commission receives all relevant information related to the credit ratings of Iberdrola, Energy East, NYSEG and RG&E, and that the customers of NYSEG and RG&E are protected in the unlikely event that Iberdrola experiences a credit downgrade:

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- **Credit Ratings** - Iberdrola, Energy East, NYSEG and RG&E will maintain credit ratings with at least two generally accepted ratings agencies (*e.g.*, S&P and Moody's).
- **Reporting of Credit Events** - If there is a "Credit Event" (defined as the downgrade of Iberdrola's, Energy East's, NYSEG's or RG&E's credit rating below "BBB-"/Baa3", or credit rating of "BBB-"/Baa3" with a "Watch Negative", by at least two major credit reporting agencies (*e.g.*, S&P and Moody's)), NYSEG and RG&E will make a timely filing notifying the Commission of any such Credit Event, and subsequent filings with the Commission every three months, identifying (1) the current credit rating during such Credit Event and (2) a plan to remedy such Credit Event, until such Credit Event is eliminated.
- **Ratings Agency Presentations and Reports** - Iberdrola, Energy East, NYSEG or RG&E, as applicable, will provide the Commission on a confidential basis with copies of all slide presentations to credit ratings agencies relating to Energy East, as well as all rating agency reports relating to Energy East or any Energy East subsidiaries, on an on-going basis.
- **Cost of Debt** - NYSEG and RG&E ratepayers shall not be responsible for any increase in NYSEG's or RG&E's cost of debt caused by Iberdrola's financial status. For ratemaking purposes, the Commission may impute a reasonable cost of debt that is based on NYSEG's and RG&E's stand-alone risk profile.

Although the likelihood of a Credit Event occurring is extremely remote, the above measures, along with Iberdrola's commitment to maintain its current strong

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"A" category credit ratings, should address the Staff Policy Panel's concerns on these issues.

D. Capital Structure Risks

Q. Mr. Azagra, do agree with the Staff Policy Panel's concerns regarding Iberdrola's capital structure?

A. No. The Staff Policy Panel raises a number of concerns regarding Iberdrola's "leveraged capital structure" (at 179) and the "amount of dividends that NYSEG and RG&E will have to upstream to Iberdrola once the merger is consummated" (at 179). As discussed in the Rebuttal Testimony of Dr. Makholm and Mr. Fetter, these concerns are without merit and are largely irrelevant to the Commission's protection of the customers of NYSEG and RG&E. In particular, the recent Iberdrola Renewables IPO raised $6.5 billion in equity to support Iberdrola's renewable capital expenditure program, and fully addressed the leverage concerns of the ratings agencies. Additionally, Iberdrola clearly states in its Strategic Plan 2008-2010 that up to 72% of its capital expenditure program will be financed by means of the Iberdrola Renewables IPO, operational cash flow, and divestments of over three billion euros. *See* IBER-0137S, Exhibit __ (JPP-1). The remaining 28% of Iberdrola's capital expenditure program will be financed by means of debt, thus resulting in a net reduction of Iberdrola's debt/capital ratio.

On the issue of dividend restrictions, it should be noted that Iberdrola's dividend policy is an integral part of its Strategic Plan 2008-2010 that has been assessed by the credit agencies as part of the larger credit analysis that led to Iberdrola's "A" category credit ratings. It is also my understanding that the

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Commission has not required dividend restrictions of the kind proposed by the Staff Policy Panel (*see, e.g.*, at 273-276) in any non-synergy transaction in New York in the past 11 years.

Nonetheless, Joint Petitioners are willing to commit to the following additional (and in Joint Petitioners' view, unnecessary) measures to ensure further that the customers of NYSEG and RG&E are protected from any remote theoretical risks that might be raised by Iberdrola's capital structure:

- **Minimum Common Equity Ratio** - NYSEG and RG&E will at all times maintain common equity capital at levels equal to or greater than 38% of total adjusted capital (including common equity, preferred equity, long-term debt, short term debt, capitalized leases, Current Maturities of Long-Term Debt and Current Maturities of Capitalized Long-Term Leases). Notwithstanding the foregoing, NYSEG and RG&E shall maintain the right to petition the Commission for an exception to this condition. One-time events, such as mandated changes in accounting, that temporarily affect equity will be reported to the Commission and excluded from the common equity ratio calculation.
- **No Cross Default** - There will be no cross default provisions in any joint credit arrangements among NYSEG and RG&E, on the one hand, and Iberdrola and its affiliates, on the other hand, unless otherwise authorized by the Commission.
- **Money Pool Participation** - NYSEG and RG&E may participate in Iberdrola money pools provided the other participants in such money pools are limited

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to regulated utility affiliates of Iberdrola in the U.S., unless otherwise authorized by the Commission. Iberdrola shall not borrow from money pools in which NYSEG and RG&E are participants.

- **Dividend Policy** - NYSEG and RG&E will maintain their respective dividend policies with due regard for the financial performance and needs of NYSEG and RG&E, irrespective of the financial performance and needs of Iberdrola. Iberdrola will report to the Commission in the event that the dividend payout for any year is more than 100% of income available for dividends calculated on a two-year rolling (eight calendar quarter) average basis.

E. Ring Fencing

Q. Mr. Azagra, do you agree with the Staff Policy Panel's recommendation that "substantial ring fencing covenants" are necessary "to protect the interests of New Yorkers by assuring that both NYSEG and RG&E are in a position to provide safe and adequate service at a reasonable price to the public" (at 242).

A. No. Ring fencing covenants are intended to insulate utility customers from the potential credit issues of a parent company. As I have discussed above, Iberdrola is a stronger, more financially stable parent company than Energy East, and NYSEG and RG&E are therefore poised to benefit financially from the Proposed Transaction. Accordingly, ring fencing provisions are not necessary in connection with the Proposed Transaction. I also note that the National Grid/KeySpan merger, in which ring fencing covenants were required, is not analogous to the Proposed Transaction since National Grid was a lower-rated company and used debt to finance its merger with KeySpan.

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For these same reasons, other extreme measures that have been proposed by the Staff Policy Panel, such as a "golden share" to provide a veto right with respect to voluntary bankruptcy petitions, are not appropriate for the Proposed Transaction. It is my understanding that the National Grid/KeySpan merger is the only instance in which the Commission has required the "golden share," a mechanism that former Chairwoman (and current Commissioner) Acampora has described as "unusual." *See* Exhibit __ (JPP-2). The Rebuttal Testimony of Dr. Makholm addresses further why a "golden share" is an unnecessary and inadvisable measure. I do note, however, that certain commitments made by the Joint Petitioners in this Panel testimony may serve as ring fencing protections, including commitments regarding separate accounting and financial statements for NYSEG and RG&E, limitations on NYSEG and RG&E assets transfers, dividend restrictions, and prohibitions against guarantees, pledges or other credit support by NYSEG and RG&E in favor of Iberdrola or its affiliates.

F. Affiliate Transaction Risks

Q. Mr. Azagra, do you agree with the Staff Policy Panel's suggestion that the Proposed Transaction will create incentives for cross-subsidization and raise other affiliate transaction issues (at 26-27)?

A. No. The Staff Policy Panel suggests that the magnitude of Iberdrola's unregulated operations "creates an incentive to misallocate costs" and that the "complexity of its corporate structure would make it difficult to follow audit trails for its complex transactions" (at 27). The Staff Policy Panel also expresses concern about Staff's ability to effectively monitor affiliate transactions "which may take place overseas, be recorded in a foreign currency (Euros), may be treated on an international accounting basis, and may be in a foreign language" (at 26-27). The Staff Policy Panel also proposes a number of revisions to the existing safeguards that are in place for affiliate transactions, which Staff claims will be "inadequate since they may not be able to capture the nuances and unknowns related to the future dealings between Iberdrola, Energy East, and the utilities" (at 294).

As more fully described in the Rebuttal Testimony of Dr. Makholm, the Staff Policy Panel's concerns with respect to affiliate transactions are without merit. Iberdrola's organizational structure is not particularly complex; it is similar to that of any organization with a variety of operating utilities and an unregulated entity that holds separately financed generation projects. In fact, it is my understanding that there are already utility holding companies with operations in New York with significantly more complex organizational structures than Iberdrola (*e.g.*, Suez). Moreover, Iberdrola has significant experience in the ownership of both regulated and unregulated operating companies, and will fully comply with the Commission's, and the FERC's, standards, regulations and policies with respect to the relationship between its regulated and unregulated affiliates (*e.g.*, Standards of Conduct, Codes of Conduct, etc.). Nonetheless, the Joint Petitioners are willing to commit to the following measures to ensure further that there are no potential incentives for cross-subsidization among NYSEG, RG&E and Iberdrola's unregulated affiliates:

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- **Cost Allocations** – NYSEG and RG&E will continue to utilize Energy East's cost allocation methodologies and Energy East will allocate centralized costs from Iberdrola to NYSEG or RG&E only to the extent that such costs are properly chargeable to utility operations and accepted by the Commission. Costs charged by Iberdrola or its affiliates to Energy East and any of its U.S. affiliates that either directly or indirectly affect NYSEG's or RG&E's costs of service shall be based on Energy East's approved cost allocation methodology, unless otherwise permitted by the Commission.
- **Separate Accounting and Financial Statements** - NYSEG and RG&E will maintain separate and independent accounting records and financial statements from that of Iberdrola and all other affiliates.
- **Asset Transfers** - NYSEG and RG&E will not transfer or sell material assets or facilities to Iberdrola or any affiliate without prior approval of the Commission. All asset sales to these entities will be on an arm's-length basis, and be subject to market vs. book value tests.
- **No Lending** - NYSEG and RG&E will not loan funds to Iberdrola or any unregulated affiliate, either through a money pool or otherwise, unless otherwise authorized by the Commission..
- **No Credit Support** - NYSEG and RG&E will not provide guarantees, collateral, or pledge or provide any other type of credit support for the benefit of Iberdrola or any affiliate.

These commitments should fully resolve any potential concerns regarding chaining transactions, costs allocation or other affiliate transaction issues.

Q. Staff has proposed in Exhibit __ (PP-25) modifications to the Standards Pertaining to Affiliates and the Provision of Information, which were set forth as Appendix B to NYSEG's 2002 Merger Joint Proposal. The document is commonly referred to as the Code of Conduct. Does the Panel believe that Staff's proposed changes are necessary or appropriate?

A. No. As Staff acknowledges, the existing affiliated transaction rules are adequate to govern the relationship between Energy East holding and services companies, NYSEG, and RG&E. Staff's primary justification for seeking to change the Code of Conduct is that it, "may not be able to capture the nuances and unknowns related to the future dealings between Iberdrola, Energy East and the utilities" (at 294).

Q. What is the Panel's overall view of Staff's proposed changes?

A. We disagree with the unilateral nature of the changes and believe that they should be rejected. The existing Code of Conduct, which has already been approved by the Commission, should remain in place, except for those provisions discussed elsewhere in this Panel testimony.

G. Other Commitments

Q. Are there any other commitments that the Joint Petitioners are willing to make to ensure that the ratepayers of NYSEG and RG&E are not adversely affected by the Proposed Transaction?

A. Yes. The Joint Petitioners continue to make the following commitments, both of which were included in the Joint Petitioners' Direct Testimony:

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- **Acquisition Premium** - NYSEG and RG&E will not seek recovery of the acquisition premium being paid by Iberdrola in the Proposed Transaction, either directly or indirectly, from customers in any proceeding.
- **Transaction Costs** - NYSEG and RG&E will not seek recovery in rates of any transaction costs for the Proposed Transaction in any proceeding. Transaction costs include investment bank fees, legal fees, transfer or other taxes, severance or change of control related payments, incremental costs for stock options and restricted stock and any other costs incurred either to complete or as a result of the Proposed Transaction.

While the Staff Policy Panel has suggested that this final commitment not to seek recovery from New York ratepayers of any costs incurred to consummate the Proposed Transaction is insufficient to prevent those costs from improper allocation at some time in the future (at 95), this concern is without foundation. The Commission clearly has the means to ensure the Joint Petitioners remain in compliance with this explicit commitment, and the Joint Petitioners have all the proper incentives to comply with a merger condition of this nature.

VII. EXISTING RG&E AND NYSEG GENERATION

Q. Mr. Rude, the Staff Policy Panel asserts that there are indications that RG&E does not intend to fulfill its commitment to sell the Russell Station to a non-affiliated company after the completion of the Rochester Transmission Project ("RTP") (at 131-132). How do you respond to Staff's assertion?

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A. Staff is incorrect. RG&E will comply with Commission orders and meet RG&E's existing obligations unless the Commission otherwise so determines. To be clear, the Commission has ordered RG&E to auction the Russell Station after completion of the RTP. As explained below, there are certain facts that have changed since the Commissions' determination on this issue, and RG&E believes it is important for the Commission to be aware of these changes. If the Commission makes no determination that alters the Commission order to auction Russell Station to an unaffiliated third party, then RG&E will proceed to develop protocols to conduct the auction after RTP begins operation.

Q. When would RG&E present its repowering scenario to the Commission?

A. In the absence of the consummation of the Proposed Transaction, RG&E had planned to make a filing with the Commission in June 2008 demonstrating the need for repowering, an assessment of alternatives to the re-powering of Russell Station, the expected costs and in-service date of its proposed re-powering project, and proposed ratemaking treatment. RG&E requests that the Commission provide an opportunity for RG&E, Staff, and any other interested parties to evaluate thoroughly the possibility of Russell Station being re-powered as a regulated project owned by RG&E. Since RG&E (like all other electric utilities in New York) remains a provider of last resort under the Public Service Law, it is incumbent upon RG&E to examine all options to meet this responsibility, including utility-owned generation. Any auction of the Russell Station should not commence until the Commission has a chance to review and rule on RG&E's repowering proposal.

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Q. Please provide background information on this issue.

A. In December 2004, the Commission granted RG&E a certificate of environmental compatibility and public need for the RTP based on a Joint Settlement Agreement reached among the parties. The Joint Settlement Agreement approved in that proceeding called for an auction of the Russell Station after completion of the RTP but did not contemplate the changes in the Rochester system that have subsequently taken place. The Joint Proposal, which was signed by RG&E, the Department of Public Service, the Department of Environmental Conservation and the Department of Agriculture and Markets, at page 30 states that "[t]he RTP would also be in the public interest because it would allow RG&E to fulfill its commitment (made on the record in RTP-0051) to follow an appropriate competitive auction process with the goal of the sale of the Russell Station site to a non-affiliated entity." The Rochester system has experienced additional growth since that time and RG&E has identified a localized reliability need within the system that cannot, and was not designed to, be met by the RTP. Based on a preliminary analysis, RG&E believes it can meet the reliability need through the repowering of Russell Station at its current site.

Q. In addition to the Russell Station, Staff has recommended the divestiture of all existing generation owned by NYSEG & RG&E. Do you agree with this recommendation?

A. No. If the goal is to avoid vertical market power, the sale of the Carthage Plant, which is a market-based unit owned by an unregulated affiliate, and certain hydro and gas peaking facilities will not impact that goal. Staff appears to want to force the utilities to sell any and all generation, without any meaningful analysis of ratepayer impacts. The Rebuttal Testimony of Dr. Hieronymus shows that there are no market power concerns associated with this generation.

Q. You testified that Staff is seeking the sale of the hydro units. Is there any harm to ratepayers if hydro assets must be sold?

A. Yes. The hydro facilities provide benefits to consumers. They are renewable resources, which New York is seeking to encourage. Hydro also provides a hedge against the volatility of market prices. Significantly, NYSEG and RG&E have owned these hydro facilities for decades and have never been required by the Commission to divest them.

VIII. Attempt to Compare Other Offers to the Proposed Transaction

Q. Mr. Rude, did Energy East entertain other offers or review certain strategic initiatives prior to its acceptance of Iberdrola's offer?

A. Yes. However, those strategic initiatives did not involve the acquisition of Energy East and are not comparable to the Proposed Transaction. As described in Energy East's Schedule 14A Proxy Statement filed September 26, 2007, Energy East was approached towards the end of the first quarter of 2007 about the possible sale of certain of its operating subsidiaries. In April, management and the Board of Directors also began to consider, on a preliminary basis, the possible acquisition of a small electric utility company.

Q. What was the result of the proposed acquisition of a small electric company and the sale of certain of Energy East's operating subsidiaries?

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A. Neither transaction was consummated.

Q. Why not?

A. As indicated in Energy East's Schedule 14A Proxy Statement filed September 26, 2007, the Board of Directors discussed the potential benefits of those two strategic transactions and determined that the benefits of completing those transactions were outweighed by the benefits associated with the Proposed Transaction with Iberdrola.

Q. Staff objects to the need for confidentiality regarding various details of the tentative transactions and the identity of the involved parties. Is the identity of the parties and the specific assets involved in exploration of these types of proposed transactions customarily kept confidential?

A. Yes. It is normal for parties to explore sensitive strategic initiatives only after confidentiality has been guaranteed. In fact, Energy East and the two interested parties entered into confidentiality agreements for both transactions. These agreements place restrictions on Energy East's ability to reveal specific information.

Q. The Staff Policy Panel alleges that Energy East has refused to provide information on the proposed transactions (at 35-36). Is this accurate?

A. It is not accurate. Energy East provided information to Staff regarding the transactions. There was a good faith dispute over the relevance of some of the information requested and that dispute has been resolved by Administrative Law Judge Epstein's ruling.

Q. Are the alternative transactions described in the Proxy Statement valid for comparison purposes?

A. No. They provide no useful basis for comparison to Iberdrola's proposed acquisition of Energy East. The two transactions are irrelevant since neither involved an alternative bid for the sale of Energy East. In other words, the sale of Energy East to a third party was not at issue in those transactions.

Q. The Staff Policy Panel claims that "since there were competing proposals, by proceeding with the Iberdrola transaction Energy East could be forgoing or could have foregone other transactions that offered synergy savings for customers" (at 36). Do you agree that the two transactions identified in the Proxy Statement are competing proposals in the sense utilized by Staff?

A. As we testified previously, there were no "competing proposals" for the purchase of Energy East. Any alleged synergies or other benefits to New York ratepayers, had the proposed acquisition of a small electric company or the sale of certain Energy East operating subsidiaries been completed, were not quantified and any attempt to do so after the fact would be exceedingly speculative since the terms of the transactions were not finalized and neither transaction was consummated. We also note that the Commission has approved many "first mover" transactions in the past.

Q. Do you agree with the Staff Policy Panel's allegations that the Board of Energy East "in evaluating several competing proposals . . . should have considered each option's chance of being approved in all jurisdictions, including New York" (at 35)?

A. No. As we noted previously, there were no "competing proposals" and none of

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the alternative transactions required New York approval.

IX. RGS Merger Commitments

Q. Mr. Rude, do you agree with the Staff Policy Panel's statements that Energy East has "not completely" followed through on its commitments when it acquired RGS (at 64)?

A. No. Energy East reasonably met its RGS merger commitments to the Commission, even though changed circumstances required some modification in how they were met.

Q. Is there a specific document that contains the RGS merger commitments?

A. Yes. The commitments made by Energy East to the Commission with respect to its acquisition of RGS were set forth in full in the Joint Proposal and the 2002 Merger Order adopting that Joint Proposal, *Order Adopting Provision of Joint Proposal with Modifications*, issued February 27, 2002 in Cases 01-E-0359 and 01-M-0404.

Q. What specific claims does Staff make regarding Energy East's commitments?

A. First, Staff alleges that RG&E's proposed rate filing in 2003 with a 6% increase was contrary to the company's commitment to provide stable rates. Staff, however, ignores the fact that the rates approved by the Commission actually froze RG&E's electric and gas base delivery rates through December 31, 2008 and limited overall increases in RG&E electric and gas revenues to $7.4 million (about 1.4%) and $7.2 million (2.2%), respectively. RG&E thus satisfied its commitment to provide stable rates. Staff also alleges that RG&E failed to

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increase its financial strength due to a downgrading of its debt. As noted in the Rebuttal Testimony of Dr. Makholm and Mr. Fetter, debt ratings are subject to various factors, including cash flow, which for regulated utilities is driven ultimately by the Commission's rate orders. Staff further ignores the inherent financial strength in RG&E becoming part of a far larger financial organization. With regard to the announcement of layoffs noted by Staff, at the time of the RGS Merger Petition, the petitioners in that transaction had no plans to reduce workforce. However, workforce reductions were ultimately necessary in light of the amount of synergies the Commission required as part of its merger approval. In addition, very few of these reductions involved involuntary separations. Staff also alleges that the petitioners' commitment to the region in that transaction was reduced rather than enhanced when Energy East's headquarters were moved to Maine. Staff ignores the fact that Energy East strengthened its commitment to the region by maintaining the headquarters of RGS, NYSEG and RG&E in Rochester, New York. In addition, significant shared service operations, including supply chain and IT, were established in Rochester. Finally, Staff argues that three RGS Directors were not placed on Energy East's Board as committed. Staff did not mention the circumstances surrounding these issues, which have already been addressed in prior proceedings before the Commission. In particular, one of the directors was elected but unable to serve and another chose to retire. The remaining RGS director was elected to Energy East Board and continues to serve to this day. There was no agreement on alternative directors for the other two positions.

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Q. Have you reviewed the Staff Exhibit __ (PP-21)?

A. Yes. This exhibit compares the value of Staff's proposed Positive Benefits Adjustments in the current proceeding with Staff's calculation of customer benefits from the National Grid/KeySpan transaction and the earlier Energy East/RGS merger.

Q. With respect to the Energy East/RGS merger, what calculation does Staff make regarding the level of customer benefits?

A. Staff's filed Exhibit __ (PP-21) shows that Staff has calculated that customers of NYSEG and RG&E received almost $821.7 million in cumulative reductions over five years, or approximately 12.6% of five-year delivery revenues.

Q. Do you agree with this characterization of the benefits from that transaction?

A. No.

Q. Has Staff indicated that it made a calculation mistake on its filed Exhibit __ (PP-21)?

A. Yes. In Staff data response IBER/EE IR No. 73, Exhibit __ (JPP-1), Staff states, "(i)n preparing this workpaper, Staff corrected errors to Exhibit __ (PP-21), and included the corrections in the workpaper. A revised Exhibit will be filed at a later time." Staff apparently realizes that its initial calculation of the Energy East/RGS merger benefits was incorrect. However, Staff's revised calculation is also incorrect and misleading. We will discuss both of Staff's calculations below.

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Q. How did Staff develop its initial calculation of $822 million in merger benefits related to the EE/RGS merger?

A. While Staff has not provided backup, we believe that Staff used the "NYSEG/RG&E Synergy Estimate, Synergy Allocation Appendix A," which was a table of projected annual merger benefits filed with the Joint Proposal in Case 01-M-0404 – Energy East/RGS Merger. The Synergy Appendix A showed a five year total net benefit figure of $164.3 million for the four Companies (NYSEG and RG&E electric and gas). The Synergy Appendix A is attached as Exhibit __ (JPP-8). It appears that Staff incorrectly multiplied total five-year net synergy benefit by another 5 years ($164.3 x 5 years) to arrive at its comparison amount of $821.7 million shown on Exhibit __ (PP-21).

Q. How has Staff revised its calculation?

A. Staff has apparently revised its EE/RGS merger benefit calculation to now equal $383.4 million?

Q. Do you agree with either calculation?

A. No. For several reasons both calculations are incorrect. Staff's initial computation utilized a five-year amount and then multiplied it by another five years ($164.332 million from Appendix A times 5 years). Staff effectively measured 25 years of net synergy benefits. Staff's revised calculation utilizes only the "year 5" benefit amount of $76.673 million and then multiplies it by 5 years. Even in its revised calculation, Staff does not utilize the five-year amount that was used by the Commission itself in approving that merger. Instead Staff has created a calculation that is misleading and an incorrect basis for its comparison schedule.

Q. Why is Staff's revised calculation misleading?

A. Because Staff did not utilize the five-year synergy amount from the Energy East/RGS merger. Appendix A of the Energy East/RGS merger clearly shows a total five-year synergy savings of $164.332 million. This amount should then be multiplied by 50% to reflect the 50/50 sharing between customers and shareholders.

X. THE CITY OF ROCHESTER'S ALLEGATIONS

Q. Mr. Laurito, does the City of Rochester ("City") support the merger?

A. In its testimony, the City states that it believes it could support the merger if certain "concerns" were resolved.

Q. What are those concerns?

A. The City alleges at page four of its testimony that is has an existing "right-of-way facilities issue" with RG&E, and asks Iberdrola to commit to a "satisfactory resolution." The City is also concerned with the aesthetics of "unsightly" utility poles and wires. Utility plants, in the form of poles, wires, and related equipment, are the basic infrastructure of energy distribution. This infrastructure traditionally has been constructed largely above-ground given that such construction is the most cost-effective way of providing reliable electric service. Recent legislation has required placing electric facilities underground for certain new construction, and in statutorily defined "visually significant" areas (such as state parks). RG&E

makes significant effort to locate its distribution lines in places that are out of public view, to the greatest degree possible. I note that none of these concerns is in any way related to the Proposed Transaction.

Q. Is RG&E responsible for the resolution of the City's concern?

A. While there generally is no legal basis for requiring underground installation at utility expense for aesthetics alone, RG&E is committed to working with the City on a project-by-project basis to do what it can, under its tariff, to accommodate the City's development interests. This may include involving the Commission where necessary.

Q. The City also references discussions with RG&E involving the purchase by the City of street lighting facilities still owned by RG&E. What is the status of those discussions?

A. The City and RG&E have been in regular communication on the sale of these facilities and are currently negotiating a fair sale price and other relevant terms and conditions.

Q. The City alleges that several RG&E facilities are characterized by "substantial unresolved environmental issues" (at 5-8). Can you comment on each of these facilities and the steps RG&E has taken, and continues to take, to deal with associated environmental issues?

A. Yes. The City identifies three RG&E facilities in which it has particular interest. It should be noted that the City's interest in these facilities is driven by a downtown development strategy that incorporates RG&E property into the City's vision. I will address each facility in turn.

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Q. What about Beebee Station?

A. Beebee Station is a generating facility that was retired in substantial part in 1999. The site still is home to a small gas turbine electric peaking facility and two substations. It is also the location of a former manufactured gas plant ("MGP") site. As such, it is included among other similar sites in a Voluntary Cleanup Agreement ("VCA") entered into by RG&E and the New York State Department of Environmental Conservation ("DEC") in 2003. Pursuant to the VCA, RG&E is preparing a remedial investigation work plan for submittal to the DEC for review. Upon approval by the DEC the investigation will be performed and the results captured in a remedial plan targeted to be initiated, based on current planning and assumptions, in 2012.

Q. Can you comment on the various buildings on the site referenced in the City's testimony?

A. Concurrent with activities under the VCA, RG&E has initiated projects to survey building materials on the property in anticipation of the eventual demolition or sale of the buildings, and remediation of the site. Additionally, RG&E has begun moving the substation facilities to a new location. That relocation work is expected to be completed by mid-2009. Demolition of certain facilities has already begun, with two stacks to be razed by March 2008, weather dependent.

Q. Why has it taken so long to prepare the site for future use?

A. The Beebee site is large and complex, having been used for a variety of utility purposes for more than ninety years. Preparing the site for a new commercial use is expensive and time consuming. It is also subject to regulatory oversight by

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several agencies, each with its own agenda and timetable. However, RG&E has clearly demonstrated by the many ongoing activities at that site and the expenditure of associated funds that it has a real commitment to managing the site in a responsible manner with all interests, including the City's, being considered.

Q. What about Andrews Street?

A. The Andrews Street facility, described by the City's witness as "an unresolved brownfield site" (at 7), is in the midst of an active remedial program overseen by the DEC. The site has a varied history, first being utilized as an MGP from the mid-1800s. It was later the location of RG&E's energy control center ("ECC"). The building housing the ECC was demolished in 2000. RG&E received an offer to purchase the site from a private developer. At the City's request, however, that offer was rejected in cooperation with the City's development plans. RG&E completed a site investigation and submitted its report to the DEC in January 2006. The DEC has yet to respond to that report. Notwithstanding the DEC's timetable, RG&E is currently preparing a remedial plan for the site so that remediation can begin as soon as possible.

Q. Why do you believe the DEC has not yet responded to the investigation report?

A. The report identified less contamination than was speculated, and given scarce DEC resources and other RG&E environmental projects, the DEC may have directed resources to sites of greater concern.

Q. What remains to be done at the site?

A. Upon DEC approval, the investigation report will be used to finalize a remedial plan which, by current estimates, is targeted to be completed and implemented by late 2009. Total costs expended to date on all activities associated with preparing the site for future use are approximately $1,000,000 plus demolition costs. Contrary to the City's allegations, the Andrews Street site is at the tail end of the regulatory process that will make it available for commercial use.

Q. What interest does the City have in the 81 South Avenue facility?

A. That RG&E facility, which currently houses a substation and breaker for Station 26, dates back to the late 1800s, and is built on the foundation of an even earlier structure important to the City for historical purposes. The City desires public access to that facility as a part of a to-be-constructed pedestrian passageway between the Rochester Riverside Convention Center and the Blue Cross Arena, via an old aqueduct.

Q. Does RG&E object to the City's interest in access to the facility?

A. No. Subject to a review of the facility's structural condition and consideration of any necessary safety enhancements and other issues required for public access, RG&E believes that the City's interest can be accommodated.

XI. CONCLUSION

Q. Does this complete the Panel's rebuttal testimony at this time?

A. Yes, it does.

BY MR. FITZGERALD:

Q. Panel, I would like to turn now to your exhibits. Were the following exhibits prepared by you or under your direction and supervision, or were they provided by another party in response to an information request for discovery in this proceeding: Your Exhibit JPP-1, consisting of responses or attachments of responses to Multiple Intervenor 4, Iber 0030, attachment to CPT, CPB 5-S, Iber 0137-S, DPS Staff responses to Iber EEIR Number 1, Iber EEIR Number 12, Iber EEIR Number 27, Iber EEIR Number 51 and Iber EEIR Number 73, Exhibit JPP-2, which is remarks from former Chairwoman Patricia Acampora to Lehman Brothers, Exhibit JPP-3, an S&P report entitled, "Spain's Withdrawal Affirmed at A Minus A-2 on IPO Completion," Exhibit JPP-4, which consists of Moody's credit opinion dated December 13th, 2007, Exhibit JPP-5, a 76-page Iberdrola quarterly report, Exhibit JPP-6, which is a one-page stock price comparison sheet, Exhibit JPP-7, a 111-page U.S. Securities Exchange Commission financial statement prepared in accordance with international financial reporting standards, Exhibit JPP-8, which is Appendix A from the Joint Proposal in Case 01-M-0404? Do you also have an additional Exhibit JPP-9 entitled, "The Joint Petitioners' Partial Acceptance," consisting of four text pages and one table which was distributed to the parties on March 14th, 2008?

A. (Mr. Laurito) Yes.

A. (Mr. Rude) Yes.
A. (Mr. Azagra) Yes.
MR. FITZGERALD: Your Honor, we'll distribute a copy of Exhibit JPP-9 at this point and give it to the reporter and to any parties who need one.
Q. Just to be clear, were these exhibits prepared by you or under your direction?
A. (Mr. Azagra) Yes.
A. (Mr. Laurito) Yes.
A. (Mr. Rude) Yes.
Q. Do you have any corrections or changes to your Exhibits JPP-1 through JPP-9?
A. (Mr. Laurito) No.
A. (Mr. Rude) No.
A. (Mr. Azagra) No.
MR. VAN RYN: Your Honor, may I interrupt for a moment? I know that in this proceeding objections to exhibits are properly going to be heard at the end of the hearings. However, I do not believe that this document is properly defined as an exhibit. Instead, it's in the nature of surrebuttal, late filed surrebuttal. Looking at this, I think the appropriate remedy at this point is that Staff will attempt to do supplemental direct when it puts its Policy Panel on. However, Staff may not be able to address all these issues this raises

through supplemental oral or direct, and I would, therefore, also reserve the right to file supplemental testimony at a later time addressing anything we feel we did not adequately address on direct here. If that necessitates that we come back for an additional hearing, so be it.

MR. SCHWARTZ: Your Honor, may I respond?

JUDGE EPSTEIN: Yes.

MR. SCHWARTZ: Your Honor, this document is not intended, nor is it, in fact, to be a supplemental piece that modifies in any way what has been produced already in this proceeding. What it is is an attempt to partially reduce the number of issues and contentions in this proceeding. So what we have done very carefully and what this panel has done very carefully, is to look at what's been proposed by other parties, including Staff, with citations and to say that we accept and that the panel accepts certain of those items in order to minimize and reduce the issues outstanding in this proceeding.

So this is not intended to be any document that results from any independent study or any independent analysis that this panel or the Joint Petitioners had undertaken. To the extent that this document proves problematic, these are the same concepts this panel on cross-examination would be willing to say in response to each individual issue that they would accept. And so, therefore, we dispute Mr. Van Ryn's contention here that this creates a necessity to then create another round of testimony for evidentiary submission in this process.

In fact, it's our view that to the extent that your Honor believes that that would be the case, that we would be in just as good a position to withdraw this document, which may not be in the interests of the other parties and the efficiency of this process and to, instead, have these witnesses respond to questions by the other parties and to Staff on each of these questions as to whether, in fact, they accept a reduction in the issues of this proceeding.

This document is merely here in order to promote that level of efficiency so that in one place we lay that out. We provided it in advance to the parties prior, instead of doing it here in this process. It is not intended to, in fact, expand the scope of this proceeding or create additional rounds.

JUDGE EPSTEIN: All right. Well, Mr. Schwartz, I agree with you that it's useful for narrowing the scope of the discussion in the hearing. So I like the idea of having it available. If, as I believe the question before us is simply whether this is an exhibit or surrebuttal, it sounds like a question that's not material, except that I'd like to resolve it in a way that doesn't create any confusion as to what the parties' rights are from this point on. I don't want to say that it's an exhibit, if that forecloses staff from making the argument that you just heard, that because of the timing, it has generated a right on their part to file additional testimony.

If -- well, I'm thinking out loud, which is always a dangerous game, but if it's testimony, if we put it in the transcript as surrebuttal, I don't see that anybody is prejudiced; am I right.

MR. VAN RYN: I agree, and I'd just like to point out, too, that we will attempt to address this on supplemental direct orally. I am merely reserving the right to later file testimony. I'm not sure that we would need to do so, and I'm trying to think about a process, a more efficient process for handling that, and I'd like some time, more time to think about that.

Let's see how supplemental direct goes, and perhaps we can discuss the procedures thereafter.

MR. SCHWARTZ: Your Honor, can I make one other statement about that? I think that that's a workable way to do it. I think it's useful to note on the record that the Joint Petitioners would oppose any effort to supplement this record with the submission of further testimony after the close of this hearing. I think it's -- I think we should all know that we believe that the evidentiary record should be closed at the end of this process that you are holding here and that there should be no need to provide additional rounds of testimony or additional oral evidentiary hearings in this process.

JUDGE EPSTEIN: All right. Well, I don't necessarily accede to that, but your point is noted for the record. Mr. Prestemon.

MR. PRESTEMON: I think Mr. Schwartz' concession answered most of what I was going to say, but I would add that we all have an opportunity to cross-examine this panel and the contents of this document now, and it probably would be more fruitful to revisit this question after that is done to let anyone who wants to do so indicate what they feel they have not had a fair opportunity to question or respond to and don't have sufficient information on.

I would hope at that point that any additional sur-direct (sic) or whatever it might be called, would be minimal. Our reading of the CPB of this document was that it was not particularly argumentative, that it did not attempt to stake out new positions or introduce new information not previously available. It was an effort to cut off issues by taking a position and agreeing to stand by it, and that, I thought, was helpful to all of us.

JUDGE EPSTEIN: All right. I don't know whether Staff will be prepared, at the end of the cross of this panel, I don't know whether staff will be prepared to make a representation that you were just calling for, Mr. Prestemon, but we'll get to that when we get to it.

The immediate question of how to enter this document, based on the discussion we have just had, this document which is entitled, "Joint Petitioners' Partial Acceptance Document," should go in the transcript as an additional piece of prefiled testimony from this panel.

MR. VAN RYN: Your Honor, could we just -- just a technical point. The last page is more in the nature of an exhibit, and Staff would agree to mark that as an exhibit, and it might help the record because it does look like an exhibit.

MR. SCHWARTZ: Your Honor, one comment. I don't mean to interrupt this question that Mr. Van Ryn just raised. One comment: You had mentioned that you would mark this as testimony. I don't think we should try to confuse this. The Joint Petitioners do not think that this would be an additional round of testimony. To the extent that it's useful for your Honor or for any other person to ask these witnesses whether they agree and adopt this stipulation and have it marked as an exhibit accordingly in this proceeding, I think would be appropriate. I don't think in and of itself it reflects testimony, until such time as somebody asks them whether, in fact, they agree to the terms of this Joint Acceptance Document, which I believe that they have already indicated that they would.

JUDGE EPSTEIN: Well, again, I'm just interested in having it in the record in some manner that doesn't prejudice Staff's argument. I don't want to prejudice the parties' argument simply because we called something the wrong name. I think the most neutral way of putting it into the record is as testimony, subject to your observation that in some ways it's not what you would ordinarily call testimony.

MR. BREW: Excuse me, your Honor, if I might --

JUDGE EPSTEIN: Mr. Brew.

MR. BREW: Actually, my suggestion would be to mark it as an exhibit for identification. My reaction to it, since so far I'm winning the pool on when the hearings will end, is that -- I am -- is that I have some clarifying questions of my own in terms of the document, as I suspect other parties do, to the extent that it's clear from the questions that this is a clarifying document as to concessions, which I view as sort of what we commonly do in rate cases where you narrow exhibits that are adjustments based on what was filed.

It strikes me as more straight forward to simply mark it as an exhibit for identification, and then we can choose to take it, and you can handle objections later.

MR. SCHWARTZ: The Joint Petitioners agree with the way that Mr. Brew just laid that out, that it would be more appropriate as an exhibit than as testimony.

MR. VAN RYN: Your Honor, we agree with your Honor.

We think it's more appropriate as testimony, with the last being the exhibit, and also, there again, I don't want to foreclose the Petitioners' right to oppose the filing of supplemental direct, but I will agree to a process that will at least make it efficient, and like I said, I'm not sure we're going to need to. So I think that issue is best put off for a couple of days and that we mark this, that we put this now in as testimony with an exhibit, that Staff present oral direct when it puts its panel on, and that the issue of what to do thereafter, we talk about when the hearings are at an end.

JUDGE EPSTEIN: Mr. Mager, is probably going to have the last word on this matter.

MR. MAGER: Well, I may never shut up, your Honor. While I think it probably is more appropriate to mark it as an exhibit than testimony, I'm okay either way. What I think is important to note for the record, though, is that this was circulated, I believe, late in the day on Friday or certainly on Friday, the business day before the start of hearings. And while I'm not objecting to its consideration here, and I think it does serve a useful purpose in terms of potentially narrowing the gap, I don't know that it gets rid of any issues, but it may narrow the gap between parties on certain issues.

I fully support Staff's position that Staff and any other party should have a reasonable opportunity to respond to it, and so whether it's through, you know, oral supplemental direct or otherwise, I think it's important that when an unscheduled, and you know, unauthorized filing is made at the eve of hearings, that parties are given a fair opportunity to respond to it. Thank you.

MR. FOGEL: Your Honor, could I just make one quick point, just procedurally? I realize Michael should have the last word. It seems to me from Staff's prospective and from the parties' prospective, I've always been of the view that testimony is more weight than an exhibit, which you can mark for identification with as much limitation as you want. And my view would be, if we simply mark it for identification, leave it for later, even if it would be incorporated into the record, it could be rejected. It's a safer bet than making it testimony at this point, and it takes on a life of its own, and then maybe you need to rebut it or not.

I think from Staff's prospective, you're safer off just marking it for identification with its limitation. If it's necessary that something further, some counter exhibit should be filed, it can be done that way, but it's a lot better than making something testimony, which I've always viewed is of a higher status and level than simply marking -- we can mark anything for identification. We can mark this table for identification. But the question is whether or not it gets incorporated in the record and how we're going to relate to it.

MR. VAN RYN: The problem, Usher, is that I think it deserves the weight of testimony. So I disagree with the premise.

JUDGE EPSTEIN: Okay. I have changed my mind for reasons that were not discussed here so far. It occurs to me that testimony sometimes is subject to a preclusion motion because it was not filed at a time that was appropriate to give other parties an adequate opportunity to analyze it and react to it before the hearing, and in substance, I believe this document was distributed around 1:30 in the afternoon on Friday the 14th, and I think I'm hearing some of the same concerns that would be expressed on a preclusion motion.

So actually, I think the more appropriate treatment of this would be to mark it as an exhibit, making clear that we're doing that for the various reasons that were discussed here today and not because we discounted in any way Staff's claim that they have the right to go on to present their case by additional means, such as supplemental direct. We're not reaching the question or prejudging in any way the question whether Staff has that right, but we're marking it as an exhibit because there is some question as to whether it might properly be precluded if it were testimony. So it will be marked. And Mr. FitzGerald, I may have lost the trail here somewhere. There must be nine exhibits by this time.

MR. FITZGERALD: Yes, your Honor, there are going to be nine exhibits by this panel. What we could do would be, mark the JPP-1 through 8 first, individually, then JPP-9 as its own separate exhibit as well.

JUDGE EPSTEIN: Forty-two through fifty.

MR. FITZGERALD: That's correct, your Honor.

JUDGE EPSTEIN: Okay, individually.

MR. FITZGERALD: That's correct, your Honor.

JUDGE EPSTEIN: So that JPP-1 is 42.

(Exhibit Numbers 42 through 50 were marked for identification.)

JUDGE EPSTEIN: Okay. And the witnesses are available.

MR. FITZGERALD: Yes, your Honor. There will be two attorneys defending the panel, Mr. Schwartz and myself. And your Honor, the witnesses are now available for cross-examination.

CROSS-EXAMINATION

BY MR. VAN RYN:

Q. Good morning, panel.

A. (Mr. Laurito) Good morning.

A. (Mr. Rude) Good morning.

A. (Mr. Azagra) Good morning.

Q. Is it correct that the State of Maine has approved Iberdrola's acquisition of Energy East?

A. (Mr. Rude) Yes, that's correct.

MR. VAN RYN: Your Honor, I'd like to have marked as an exhibit the Order approving Stipulation for the State of Maine Public Utilities Commission addressing Iberdrola's acquisition of Energy East.

JUDGE EPSTEIN: Fifty-one.

(Exhibit Number 51 was marked for identification.)

Q. And the procedure followed in Maine was that the Commission approved a settlement among the parties that's called Stipulation; is that correct?

A. (Mr. Rude) That's correct.

MR. VAN RYN: Your Honor, I'd like to have that document marked as well.

JUDGE EPSTEIN: Fifty-two.

(Exhibit Number 52 was marked for identification.)

Q. And under Maine's procedures, there was a prior document issued in the proceeding known as a Bench Analysis; is that correct?

A. (Mr. Rude) That's correct.

MR. VAN RYN: Your Honor, I have selected pages from the Bench Analysis that I would like to have marked as an exhibit.

JUDGE EPSTEIN: Fifty-three.

(Exhibit Number 53 was marked for identification.)

MR. SCHWARTZ: Your Honor, I just wanted to note that Exhibit 52 that Mr. Van Ryn had marked does not appear to be a complete copy. I don't know yet what pages are missing, but it seems that it ends on page 15 of the Stipulations, and I think we just need to confirm and check that all the pages are here. We would like to reserve the right to work with Mr. Van Ryn to make sure that that's complete, and if not, we would supplement it to make sure it's a complete copy.

MR. VAN RYN: Yes, your Honor. Wherever we've used excerpts from documents, of course, we would -- if the company has any objection, we will either provide the full document or allow the company to do so.

JUDGE EPSTEIN: Okay.

Q. And if you could turn to page four of the Maine Order. In there it describes the tests that must be met under Maine law in order for a merger to receive approval. In your view, is it correct to characterize that test as met if there is no harm to ratepayers from the transaction?

MR. FITZGERALD: Your Honor, we're just going to object again. It's calling for a legal conclusion.

MR. VAN RYN: Well, your Honor, these are expert witnesses. I'm not asking for their legal opinion. I'm merely asking for how they understand the Order. I fully understand that, upon brief, the Petitioners will fully explain their view of the law in Maine. I'm merely asking for the layman's understanding of this panel?

JUDGE EPSTEIN: Okay. Mr. Van Ryn, I don't see the discussion that you're referring to. Is it page 4 of the Order? It may be there, but I'm just not picking up on it?

MR. FITZGERALD: Your Honor, it's Exhibit 51.

MR. SCHWARTZ: I think Mr. Van Ryn is referring to the paragraph beginning with "Finally." Is that right, Mr. Van Ryn.

MR. VAN RYN: Yes.

MR. SCHWARTZ: Your Honor, what Mr. FitzGerald had stated, we would just like to reiterate, under Maine law like under New York law, there are legal arguments as to what's needed to meet the burden and that the language in the statute is not entirely clear, and that, therefore, this really is legal conclusion with respect to what is needed to meet the burden under Maine law.

JUDGE EPSTEIN: Right. Okay. So, Mr. Van Ryn, are you asking them -- are you just calling their attention to this recital by the Maine Commission, or are you asking them to --

Q. Let's put it this way -- let's see if I ask this question: Would you agree that the Maine Commission said they would approve of the merger if the total benefits are equal to or greater than the detriments or risks to ratepayers and shareholders?

A. (Mr. Rude) That's what they concluded in this Order.

Q. And later on in the Order, it states that Maine ratepayers will benefit because Energy East will not recover the acquisition premium paid for Central Maine in future revenue requirement calculations, and Central Maine will agree to levelize the revenue requirements associated with its proposed advanced metering infrastructure investment. Is that your understanding of the Order?

A. (Mr. Rude) Those are two of the benefits that they cited, yes.

Q. And is it correct that the metering infrastructure investments carrying charge that was forgone was valued at about $86 million?

A. (Mr. Rude) Not by the company.

Q. Was it valued that way by the Commission?

MR. FITZGERALD: Mr. Van Ryn, do you have a reference to that in the Order?

MR. VAN RYN: A moment, your Honor. I'll withdraw that last question.

Q. Do you know what the company valued that adjustment at?

A. (Mr. Rude) We didn't put a monetary value on that, because the AMI system, as to whether or not it will be installed, is the subject of another proceeding.

Q. So you're saying that the value of that carrying charge will be determined at a later time?

A. (Mr. Rude) I believe the levelization that we agreed to was due positively, because it would have the effect of lowering revenue requirement for that system if it went in at the beginning, but again, all the details associated with that really are part of another proceeding.

Q. So it's correct to say the monetary value will be determined at a later time?

A. (Mr. Rude) Of that levelization concession as part of the overall project, yes.

Q. And there's also a monetary value to the acquisition premium that will not be recovered from Central Maine?

A. (Mr. Rude) The effect of that was to reduce the, essentially reduce the cost of service requests in CMPs of alternative rate plan filing for the first year, and an adjustment to that revenue requirement was made by CMP after this Order was issued.

Q. When Energy East initially requested approval of the merger from the Maine Commission, did it at that time say that there were no risks or costs to consumers in Maine?

A. (Mr. Rude) I would have to refresh my memory on that.

It's been quite a few years.

MR. VAN RYN: If you could do so, we'd make that a transcript request.

Q. And also at the time it requested approval, did it identify non-monetary public policy benefits to the State of Maine from the merger?

MR. FITZGERALD: Mr. Van Ryn, just to clarify your question, were you referring at the time we printed the prior transaction? It wasn't clear to me which transaction you were referring to.

MR. VAN RYN: No, Iberdrola's acquisition of Energy East.

A. (Mr. Rude) Again, if I can have an opportunity to refresh my memory in that.

MR. VAN RYN: I will make that a transcript request.

Q. Switching to another topic, if you could turn to page 73 of your testimony?

MR. FITZGERALD: Mr. Van Ryn, because of the page number, I'm assuming you're referring to the Joint Petitioners' Policy Rebuttal at this point; is that correct?

MR. VAN RYN: Yes.

MR. FITZGERALD: Thank you.

Q. In there, to summarize your testimony, you were critical of a Staff calculation that multiplies the year five benefit from the prior RGS merger that led to the formation of Energy East, and they take that year five benefit of approximately $77 million and multiply it by five years; is that correct?

A. (Mr. Rude) Yes, that's correct.

Q. Now, in the merger between NYSEG and RG&E that formed Energy East, NYSEG was allowed to retain fifty percent of the net synergies from the merger; is that correct?

A. (Mr. Rude) I think it would be more correct to say that NYSEG rates reflected fifty percent of the synergies for the customer on this appendix.

Q. And that was for a five-year period; is that correct?

A. (Mr. Rude) That's correct, for the period of the rate plan.

Q. And at the end of that five-year period, the savings would continue to flow through to ratepayers thereafter; is that correct?

A. (Mr. Rude) The way the rate plan was designed, that question was left open, but in NYSEG's last rate case, all of those synergies went back to ratepayers.

Q. Including for the next five years; is that correct?

A. (Mr. Rude) Forever.

MR. VAN RYN: One moment, your Honor. Your Honor, I have another document I would like to have marked as an exhibit.

Your Honor, this document is two pages from an Appendix to the Bench Analysis submitted earlier. We're doing this for convenience. Again, if there's anything else in the Bench Analysis that the Petitioners would like to see in the record, we will, of course, agree to put it in.

JUDGE EPSTEIN: Fifty-four.

(Exhibit Number 54 was marked for identification.)

MR. VAN RYN: I also need to apologize for the fact the pages in this seem to be reversed. It should be pages 1 and 3. It's 3 first and 1 second.

MR. SCHWARTZ: Your Honor, I just wanted to ask Mr. Van Ryn -- this is the Bench Analysis. Can you clarify what document this is.

MR. VAN RYN: This is an Appendix to the Bench Analysis that we submitted earlier.

MR. SCHWARTZ: Bench Analysis from --

MR. VAN RYN: -- the State of Maine.

JUDGE EPSTEIN: It's an Appendix to Exhibit 53?

MR. VAN RYN: Yes.

MR. FITZGERALD: Mr. Van Ryn, the handout that we received said before, "The State of New York, Public Service Commission," as a cover page.

MR. VAN RYN: Yes, that's the exhibit cover page.

MR. FITZGERALD: Right, and then the two pages that follow are Appendix Merger Premiums, page 1, and Appendix Merger Premiums, page 3. I just wanted to make sure they were stapled backwards.

MR. VAN RYN: Yes.

MR. FITZGERALD: Thank you.

MR. SCHWARTZ: Your Honor, I think maybe this is in the form of first a clarification of Mr. Van Ryn. Do you know which Maine regulatory proceeding this is part of.

MR. VAN RYN: Yes, it's in the Maine Docket 2007-315.

MR. FITZGERALD: Your Honor, for clarity we would ask that the full document be marked or substituted for these pages at a later time just for clarification.

MR. SCHWARTZ: One other thing, I think the separate matter is that this document may not be the merger proceeding. This document may be the Bench Analysis for the different rate proceeding that deals with what in Maine they call the "Arc," and therefore, we would like to reserve rights to object to the introduction of this as to whether it's relevant to this proceeding.

MR. VAN RYN: He has correctly characterized the document. As to relevance, let me ask the question, and we'll see.

MR. SCHWARTZ: Just for purposes of clarification so everyone knows, your Honor, what this document is, it's a -- there is a rate proceeding that was commensurate with the merger proceeding that actually predated the start of the merger proceeding, and this is a Bench Analysis from that rate proceeding.

JUDGE EPSTEIN: Okay. So, Petitioners, you're reserving your objections based on relevance.

MR. SCHWARTZ: Yes, your Honor.

MR. BREW: Excuse me, your Honor. Could I get a clarification? Is Exhibit marked for identification 54 an Appendix to Exhibit 53, or are they different bench memos.

MR. SCHWARTZ: I don't have a copy of 53 yet, so I haven't seen that yet. I'm sorry. I do have that.

MR. VAN RYN: Just a moment, your Honor.

MR. SCHWARTZ: We would have to check, your Honor. I think these are two separate proceedings.

MR. VAN RYN: Mr. Schwartz is correct. It's an appendix to the separate bench memo in the rate proceeding that he described.

MR. SCHWARTZ: With separate docket numbers, I believe, Mr. Van Ryn.

MR. VAN RYN: Yes, that's correct.

MR. SCHWARTZ: Do you have the entirety of these documents for the record.

MR. VAN RYN: Why don't we discuss afterwards what you would like to see on the record, because these documents in some cases are many hundreds of pages long and contain a lot of extraneous material. So why don't we discuss that at some point what you would like to see.

JUDGE EPSTEIN: Okay. That's good.

Q. And to get to the question, could you please refer to the exhibit, page number 3. In there there's a chart labeled, "Allocation to Premium to NYSEG." Is that correct.

A. (Mr. Rude) Yes.

Q. And as described in that chart, the total synergies were 120 million; is that correct?

A. (Mr. Rude) That's what the chart says, yes.

MR. VAN RYN: Turning to another topic, I'd like to discuss with the panel Iberdrola's relationship with Gamesa Energy, and I have two documents I would like marked for identification. The first document is response Iber 203, and the second is response Iber 227.

JUDGE EPSTEIN: Okay. That's 55 and 56.

(Exhibit Numbers 55 and 56 were marked for identification.)

Q. Please turn to Iber 203.

MR. FITZGERALD: Your Honor, we haven't yet received a copy of the materials. One moment. Thank you, your

Honor. We now have copies.

Q. In there it states that Iberdrola owns nearly 25 percent of Gamesa; is that correct?

A. (Mr. Azagra) That is correct.

Q. And Gamesa is developing two wind projects in New York State; is that correct?

A. (Mr. Azagra) That is correct.

Q. And even though Iberdrola owns a 25 percent interest, the response states that Iberdrola does not have any access to information of Gamesa's projects and activities by virtue of this interest; is that correct?

A. (Mr. Azagra) You mind to repeat the question?

Q. Sure. If you could just -- the last line on the first page of the IR response, the last sentence on the first page of the IR response --

A. (Mr. Azagra) Yes.

Q. And if you return to --

MR. SCHWARTZ: Just to clarify the question, which IR response are you referring to here?

MR. VAN RYN: Two zero three.

MR. SCHWARTZ: So it's the last line on that, William Hieronymus response.

MR. VAN RYN: Yes.

Q. And if you turn to Iber 227, that describes the ownership interest, Iberdrola's shares with Bank BBVA of a holding company known as IBV, and it also states that through that holding company, Iberdrola owns some interest in Gamesa?

A. (Mr. Azagra) It's my understanding not any longer, because it was sold in the past, you know, in the past week.

Q. The interest in IBV or Gamesa?

A. (Mr. Azagra) No, IBV's interest in Gamesa.

Q. IBV's interest in Gamesa was sold?

A. (Mr. Azagra) Yes.

Q. To whom?

A. (Mr. Azagra) Partially to us and then to BBVA. I'm not aware exactly, you know, what to BBVA and what BBVA did with that, but we took a portion of that. So it's direct ownership now by withdrawal.

Q. So your direct ownership interest now exceeds 25 percent?

A. (Mr. Azagra) I believe so. I think it's around 24 percent. It's a little bit less than 24 percent.

Q. During the time Iberdrola participated in the management of IBV, it stated that its role is to collaborate with the other owner of IBV with respect to new investments and to monitor the performance of existing investments. Now, how did you acquire the information on Gamesa necessary to perform the monitoring function you described?

A. (Mr. Azagra) I'm not aware of that. I'll come back to you with the information, if we have it.

Q. You also report in Iber 203 that an Iberdrola subsidiary has purchased the interests of Gamesa's subsidiaries in proposed wind farms located in Pennsylvania, Texas and Illinois; is that correct?

A. (Mr. Azagra) That's correct.

Q. How did Iberdrola obtain information on those projects that Gamesa owns sufficient to justify their acquisition of them?

A. (Mr. Azagra) Those projects, as I understand, you know, it's part of the framework agreement between Iberdrola Renewables and Gamesa for the purchase of some assets. So our knowledge of that would come through Iberdrola Renewables, that it was closed before Iberdrola Renewables was IPO'ed. It was, you know, at that time, it was a hundred percent owned subsidiary.

Q. And would it be possible to enter into a similar framework agreement concerning the New York projects if Iberdrola or Gamesa so desired?

A. (Mr. Azagra) There is no reason. They could sign with any other party.

MR. VAN RYN: A moment, your Honor. Your Honor, I have another IR response I'd like marked for identification. This is Iber-8-S.

JUDGE EPSTEIN: Fifty-seven.

(Exhibit Number 57 was marked for identification.)

Q. And in this IR response, Iberdrola reports that its affiliates are planning to develop additional wind projects in New York; is that correct?

A. (Mr. Azagra) That is correct.

Q. And that several of these projects are planned for interconnection with the NYSEG transmission system; is that correct?

A. (Mr. Azagra) The connection request has not been requested yet, but they will be -- if they were to be, they would be interconnected to that utility.

MR. VAN RYN: Turning to another topic, your Honor, I would like marked for identification a document from Market Watch authored by David Roman.

JUDGE EPSTEIN: Fifty-eight.

(Exhibit Number 58 was marked for identification.)

Q. In this news report -- excuse me. Strike that. This news report discusses plans supposedly made by EDF, a large French utility, to acquire Iberdrola. Does Iberdrola have any comment on this news report?

MR. SCHWARTZ: Your Honor, just as a notation, we would like to reserve objections to documents like this that may not have proper foundation for introduction into evidence, but with that reservation, we have no objection for continuing this level of cross.

A. (Mr. Azagra) I think Iberdrola's communication policy basically is very simple. We don't comment to market rumors, to media rumors which are not real facts for the company to be involved in.

MR. VAN RYN: Your Honor, to conclude my cross, I have some questions I would like to ask on confidential responses to Iber 361 through 363. So we need to make arrangements now to create a confidential record.

MR. SCHWARTZ: As a procedural matter, your Honor, I think that I would just like to know how you intend to do this. Our only preference would be to do it efficiently. We have no objection to proceeding in this fashion. It may make sense to allow, just from an expeditious standpoint, to allow other people to ask their questions before we turn on and off microphones, but my only inquiry is as to timing.

JUDGE EPSTEIN: Yes, according to the estimates, there are possibly a few more hours of cross for this panel. So --

MR. VAN RYN: If the parties feel it's more efficient for me to wait till the end, I'll happily do so.

JUDGE EPSTEIN: Okay. Mr. Brew.

MR. BREW: Your Honor, I expect my cross to be substantially shorter than what was on the sheets, particularly since I expect that some of my areas and Mr. Mager's are overlapping.

JUDGE EPSTEIN: Yes.

MR. PRESTEMON: I'm notoriously bad at these estimates but expect mine will be shorter than the one hour I put down, too.

JUDGE EPSTEIN: Okay. I'm just thinking in terms of this, that the planned break was around 11:00. So that if the other parties completed their cross around sometime approaching 11:00, then at that point that might be a convenient time to the confidential portion of the cross. Okay. So you're okay with that, Staff.

MR. VAN RYN: Yes.

JUDGE EPSTEIN: Okay. So let's go on to the next cross-examiner.

CROSS-EXAMINATION

BY MR. MAGER:

Q. Good morning, panel.

A. (Mr. Laurito) Good morning.

A. (Mr. Rude) Good morning.

A. (Mr. Azagra) Good morning.

Q. I have a number of questions regarding Exhibit 50, the Joint Petitioners' Partial Acceptance Document. Could you please get that handy. Do you have it? Let's start with some questions regarding the section entitled, "Vertical Market Power," specifically, the Joint Petitioners' Acceptance. Can you identify the location of the generating plants that the Petitioners have offered to divest?

A. (Mr. Rude) Yes, the Russell Station, the Allegheny Station, the Peaker Station 3 and Peaker Station 9, all in the Rochester, New York area. The Carthage Peaking Unit, it is my understanding that's in the, near the Watertown area or in that Tug Hill Plateau area.

Q. Okay. And that's not part of the company's service territory, correct?

A. (Mr. Rude) That's correct.

Q. And what are the approximate book values of those units? Are they fully depreciated?

A. (Mr. Rude) Only Russell Station is fully depreciated and is being readied for closure. We would have to provide the other book values, but they are relatively small.

MR. MAGER: Okay. Can I make a request to have entered into the record the book values of the other generating units?

MR. FITZGERALD: We'll take that under transcript requests.

MR. MAGER: Thank you.

Q. You stated in the paragraph, Joint Petitioners' Acceptance, that "The above commitments are subject to reasonable protocols determined by the Commission which should provide that such assets would not be sold below book value." Do you see that?

A. (Mr. Rude) Yes.

Q. Does that agreement not to sell the units below book value apply to the units individually or in the aggregate?

A. (Mr. Rude) I believe that would be worked out in the determination of the protocols.

Q. So at this point the company doesn't have a specific proposal that it's advancing on that?

A. (Mr. Rude) That's correct.

Q. And would these reasonable protocols be decided in this proceeding?

A. (Mr. Rude) Subsequent to this proceeding.

Q. Now, to the extent a single purchaser was to acquire all of those generating units, at least the ones within the RG&E service territory, would there be any market power concerns?

A. (Mr. Rude) I don't think I'm equipped to respond to that.

Q. Okay. Who would pay the costs associated with auctioning the units under your proposal?

A. (Mr. Rude) Again, that would be subject to the protocols. What typically happens is the transactions costs are netted against the proceeds.

Q. Is the company making a specific proposal in this proceeding on how the costs would be treated?

A. No, we are not.

Q. How would the auction proceeds be treated?

A. (Mr. Rude) This Acceptance Document doesn't speak to that.

Q. So the company is not making any proposals in this proceeding as to who would get the money if the plants are sold?

A. (Mr. Rude) That's correct.

Q. Would you agree that customers paid -- withdrawn. With the exception of the Carthage Peaking Unit that's owned by Cayuga Energy, would you agree that customers paid for the construction, operation and maintenance of the other generating units through rates?

A. (Mr. Rude) Yes.

Q. What is the estimated value of those units should they be divested?

A. (Mr. Rude) We haven't done that study, Mr. Mager, to determine what that value would be.

Q. And so my understanding is that if this merger was to be approved, this part of your Partial Acceptance Document would not produce any financial benefits to customers?

A. (Mr. Rude) It would really be our opinion, or I could say my opinion, that I believe it would. I believe that given the relatively low book values here and flexibility in how the auction was conducted could, in fact, produce value. To the extent the Commission determined that that value should go back to customers, then that would be a substantial value in this proceeding.

Q. And so would you agree that the more, the larger percentage of auction proceeds that went to customers, the larger the potential financial benefits would be?

A. (Mr. Azagra) I think, you know, the potential is that there are more. I think there are. So I think, you know, a part of those gains, you know, go to customers. That's what I figure. In our opinion the question is, you know, if there are more, then it could have been just by, you know, going to the customers, part of that, you know, there would be a benefit.

Q. Well, there would also be a potential cost, would there not, in terms of the customers would lose the benefit of that generation; isn't that true? Let me ask the question again. Do customers currently receive any benefit from RG&E owning those generating units?

A. (Mr. Rude) The market value of that generation is returned to customers.

Q. And so that benefit would be lost if the plants are sold?

A. (Mr. Rude) Not necessarily. It depends on how that sale was structured and if there was a contract associated with that and how rates were set. I mean, those details are to be worked out. I would not conclude that it would be a detriment to customers.

Q. But sitting here today, you don't know whether the benefits to customers in the form of failed proceeds would outweigh the benefits to customers of retained ownership?

A. (Mr. Rude) No, but this concession is made to resolve the vertical market power issue. So if there is one dollar of financial benefit, beyond that, then it's a bonus.

Q. And so for purposes of this proceeding, the company is not assigning any dollar value benefit to customers with respect to this acceptance; is that fair?

A. (Mr. Rude) That's correct.

Q. Okay. Would the company commit in this proceeding that 100 percent of the auction proceeds be allocated to customers?

A. (Mr. Rude) Are we negotiating?

Q. I'm asking if the company would accept that.

MR. SCHWARTZ: Can I ask a clarifying question? Mr. Mager, are you referring to footnote 3 on the Partial Acceptance Document?

MR. MAGER: No.

A. (Mr. Rude) I'm not comfortable making those types of commitments in a vacuum. I'm sorry.

Q. Let's turn to the section of your document entitled, "Positive Benefit Adjustments." Do you see that?

A. (Mr. Rude) Yes.

Q. And in that section of the document, the Joint Petitioners are agreeing to provide customers with 201.642 million in PBAs; is that correct?

A. (Mr. Rude) That's correct.

Q. How was that number chosen?

A. (Mr. Rude) Carefully.

Q. Please elaborate.

A. (Mr. Rude) We really have a variety of factors that went into it. We started with the Staff recommendations, and we looked at, frankly, what we thought we could live with and then tried to select items among that list that might make some sense and produce the most benefit.

Q. When you say you tried to select what in Staff's list you could live with, are you referring to the total dollar value, or are you referring to the specific, the substance of the specific adjustments?

A. (Mr. Rude) Both really, but principally the total dollar value.

Q. Why did you choose these specific adjustments to get to the roughly $200 million figure as opposed to other adjustments?

A. (Mr. Rude) There wasn't one theme that connected all of these. Again, it was an approach that tried to select something that we thought would make the most sense and, again, would have the most impact. For example, the loss on re-acquired debt affected all the companies involved here. So it spread that benefit among all the companies. The flood regulatory asset and the environmental reserve, again, it had an environmental theme that we thought was important here and important for customers. And then the Nine Mile, the two Nine Mile regulatory assets because of their size, provided substantial value for customers, if they were recovered rapidly in this case. So it was really a combination of those, those items and that thinking that led to the selection.

Q. Would you agree that those type of considerations could also justify other adjustments identified by Staff?

A. (Mr. Rude) It's possible or other considerations.

Q. What went into the thinking in terms of allocating the PBAs between RG&E and NYSEG?

A. Other than the loss on re-acquired debt, it pretty much fell out this way. The environmental reserve at NYSEG, they had more of the environmental sites to clean up. So it made sense for that to be a NYSEG item. So again, it wasn't so much between the two companies as to really how it fell out, given our other thinking.

Q. Were you trying to strike any sort of balance between allocations to RG&E and NYSEG, and if so, what?

A. (Mr. Rude) No, we didn't.

Q. Did you try to strike any type of balance between allocations to electric operations and gas operations?

A. (Mr. Rude) No, with the exception of, as I mentioned, the loss on re-acquired debt which did touch all of the companies.

Q. For instance, just let me draw your attention -- it seems like for NYSEG, the electric benefits are roughly three times the gas benefits, whereas, for RG&E the electric benefits are maybe seventy or eighty times the amount of gas benefits. Was that intentional?

A. (Mr. Rude) I think that's just purely a function of the size of the Nine Mile reg. assets.

Q. Now, looking at attachment one to Exhibit 50 where you identify these specific PBAs, you have -- the bottom line of that chart is "Total PBAs Pretaxed." Do you see that?

A. (Mr. Rude) Yes.

Q. How would the tax treatment work for these adjustments, and what would be the approximate value after taxes?

A. (Mr. Rude) There would be -- there's deferred taxes on these items. I would have to get that information for you and read it into the record.

MR. MAGER: Okay. I would like to make a transcript request for the post tax value of the PBAs.

MR. FITZGERALD: We can provide that.

Q. Would the post tax value to customers be higher or lower than what's shown as the pretax?

A. (Mr. Rude) Well, the value is the same. It's just one is pre and one is post tax, and then determining how it was returned to customers, that's also a factor.

Q. Well, let's discuss that. What would be the rate impacts on customers if these adjustments were adopted and the merger was approved and these adjustments took effect July 1, 2008, as you propose?

A. (Mr. Rude) One second, please. The determination on this, as we have put in here that we would -- certainly, the Commission would be able to determine how that benefit would be flowed through the customers, but if it was done in terms of a rate reduction simultaneously with or very close to when the write-offs occurred, then we estimate that that would be about $50 million.

Q. Okay. So all of the PBAs listed on attachment one collectively would amount to a $50 million rate decrease for customers?

A. (Mr. Rude) Approximately, yes.

Q. And that's combined NYSEG and RG&E?

A. (Mr. Rude) That's correct.

Q. Do you have a breakdown for both, for each?

A. (Mr. Rude) I could provide an approximation.

MR. MAGER: Could I make an on-the-record request for that as well?

MR. FITZGERALD: Yes. To the extent the witness said he could provide an approximation, we will.

MR. MAGER: Okay.

Q. What are the approximate combined delivery revenues for NYSEG and RG&E electric and gas?

A. (Mr. Rude) Again, if I could just take that and make sure I don't make a mistake.

MR. MAGER: I would like that as well.

MR. FITZGERALD: Could you clarify what year you're speaking of and what revenues particularly?

MR. MAGER: I'll take any recent 12-month period. I'm looking for the total delivery revenues for electric and gas for both NYSEG and RG&E.

Q. Sitting here today, do you have any idea what percentage rate decrease $50 million would be on the combined NYSEG and RG&E operations?

A. (Mr. Rude) I'll provide that when I provide the approximation.

Q. Okay. Now, with respect to the PBAs, am I correct that the company has not proposed any type of stay-out with respect to future rate cases?

A. (Mr. Rude) Not within this document, but the company has proposed in a separate filing that the RG&E electric and gas rate plans continue.

Q. Until when?

A. (Mr. Rude) Just continue. There's no term to the request. The provisions are designed to continue, subject to review by the Commission.

Q. So -- well, let's just take an example. Let's say the merger is approved and is consummated July 1st, 2008. Am I correct that on July 2nd, RG&E can file a new electric rate case under your proposal?

A. (Mr. Rude) No, no. The rate plan continues through the end of '08.

Q. And the company is precluded from filing for new rates through the end of '08? Isn't it true that the rates, that the company is entitled to file a rate case at any time?

A. (Mr. Rude) I believe we would violate that rate plan if we filed -- we could file -- I beg your pardon. We could file a rate case for rates that were effective after '08. That's correct.

Q. So under your proposal, on July 2nd, RG&E could file a new electric rate case, correct?

A. (Mr. Rude) But that's not what we've done. We filed a proposal to continue the current rate plan.

Q. But even under that proposal, you would still be permitted to file a new rate case on July 2nd?

A. (Mr. Rude) I believe the Commission would have to act on our continuation filing first.

Q. Under what provision of the rate plan do you believe you're precluded from filing a new rate case?

A. (Mr. Rude) Not precluded, but we've made the decision to request that the rate plan continue. To file a rate case while that's pending wouldn't be the correct thing to do.

Q. So if the Commission never rules on your request to extend the rate plan, you essentially can file new rate cases?

A. (Mr. Rude) The company would continue the rate. If they didn't rule, the company would continue the rate plan as it is at the current rates.

Q. For how long?

A. (Mr. Rude) Until either the Commission asks us to file a case or we decide to file a case.

Q. And can you decide to file a case on July 2nd, 2008?

A. (Mr. Rude) I just think that would be -- that's not what the company would do, because the company has already made it known that we want the current rate plan to continue in '09. So I think that would be disingenuous.

Q. Again, I just want to be very clear in my question. I'm not asking what the company intends to do or may not do. What I'm interested in is, what would the utility be allowed to do if it's Partial Acceptance Document is accepted?

A. (Mr. Rude) I don't want to try to provide some legal opinion, but it seems to me that the fact that we have a filing pending with the Commission to continue the current rates, that it would be improper, if not illegal, to file a rate case while that continuation filing is pending.

Q. Okay. Same question with respect to NYSEG. Under this Partial Acceptance Document, NYSEG could file for new electric and gas rates on July 2nd, 2008, correct?

A. (Mr. Rude) That's correct.

Q. So it's possible the day after the merger closes, the company could seek relief in excess of the PBAs given to customers under Exhibit 50?

A. (Mr. Rude) There's a number of possibilities. That is not the company's plan.

Q. Did the company consider agreeing to stay-outs for RG&E and NYSEG as part of this Partial Acceptance Document?

A. (Mr. Rude) We did not consider it. What we considered was returning these benefits to customers as soon as possible.

Q. Would the agreement to refrain from seeking rate increases, following the merger for some period of time, be a benefit to customers?

A. (Mr. Rude) Well, I don't know if it would be a benefit to customers. I mean, there were others that would have to determine that, but it does fit with the company's plans. As I told you, we filed a continuation filing for Rochester. It is the company's intention to continue the NYSEG gas plan. That plan is permitted to continue without a filing, and we have no plans to file a NYSEG electric case. So in that scenario, those stay-outs are planned.

Q. So to the extent the Commission directed NYSEG and RG&E to stay out of filing rate cases for some period of time following the merger, that would not be inconsistent with any of the company's current plans?

A. (Mr. Rude) It would depend on the nature of that order but generally consistent, yes.

Q. Now, let's turn to section three, the renewable commitment section. Specifically, I want to direct your attention to the paragraph that starts "Joint Petitioners Acceptance." Do you see that?

A. (Mr. Azagra) Yes.

Q. And specifically, I want to first draw your attention to the beginning of that where it says, "So long as the Commission does not impose any limitations on the ability of Iberdrola Renewables to develop renewable generation in New York State as a result of this proceeding," what do you mean by that language?

A. (Mr. Azagra) Basically, to have the certainty that Iberdrola Renewables may continue to develop any renewable opportunity in the State of New York.

Q. Now, if the Commission were to rule that no wind could be developed within the NYSEG and RG&E service territories, Iberdrola would still be allowed to build new wind projects elsewhere in the state; would it not?

A. (Mr. Azagra) I guess, legally, we don't refer to service territory for these purposes. We refer it, you know, to whether some assets are interconnected to our company or another one, you know, transmission owner, transmission assets. So we tend not to service territories for these purposes. But what you said, you know, it could be like that if that's what the Commission -- we will not agree with that -- but that's what the Commission could rule.

Q. And right now, Iberdrola owns existing wind projects, but none of them are in the NYSEG and RG&E service territories; is that correct?

A. (Mr. Azagra) That is correct.

Q. And it has some projects that are identified that are in the New York ISO for development; is that correct?

A. That is correct.

Q. And those are also not in the RG&E and NYSEG territories?

A. (Mr. Azagra) That is my understanding.

Q. Okay. And then --

A. (Mr. Azagra) Again, I would like to refer to be or not be interconnected to the company. To talk about the service territory we think is different.

Q. Okay. And turning to Exhibit 57, which I believe you still have up there, the company is now proposing to develop at least three wind projects that would be interconnected to NYSEG; is that understanding correct?

MR. SCHWARTZ: Just as clarification, which document are you referring to?

MR. MAGER: Exhibit 57, which is Iberdrola response 0008-S.

MR. SCHWARTZ: Thank you.

A. (Mr. Azagra) That is correct, but as I mentioned before, they haven't asked for interconnection yet. You know, this is very customary in the wind development business. There are many projects, you know, different pipelines, you know, different degree of certainty into the pipelines of companies, continues to plan development which basically, you know, you have the certainties which are real and start operation, you know, construction and have certainty when you will start the construction and have certainty when it comes in operation, and there are many, you know, many other assets, you know. You know, we have Iberdrola, about 47,000 megawatts of pipeline. I think in Iberdrola's idea, we made it very clear, we will make three different categories, instead of probability of the pipeline becoming real. And I think, you know, in the Iberdrola

Renewables, they continue to identify potential assets which are, you know, very far from becoming real. Let's make it clear. You know, we will support Iberdrola Renewables, you know, to promote and develop as much wind as possible in the State of New York, as we do everywhere else.

Q. One thing I'm interested in Exhibit 57 is a revised or supplemented response, and the initial response did not list any projects that would be interconnected to NYSEG.

A. (Mr. Azagra) Correct.

Q. And so I'm just curious as to, at some point during the merger proceeding, after the merger was already announced, Iberdrola then decided it would want to develop three additional, three new generation projects that would have to be interconnected to NYSEG.

A. (Mr. Azagra) Let me explain, again, you know, how renewables development works. Internally, and again, you know, now Iberdrola Renewables is an independent company. So I think, you know, we need to think about that as well, you know, in terms we are an eighty percent shareholder of the company. The way, you know, we do the renewables' review every X number of months for review of the pipeline, and that -- you know, the pipeline, you know, there are megawatts coming in, and there are megawatts coming out. That happens all the time. If you just review the overall pipeline, you know, which is different from the development plan, which is, you know, what we have said to the investors we're going to be doing in the next, you know, one or two or three years, you know, especially with names, specific assets becoming real, and that's, you know, what Iberdrola Renewables has been explaining to the markets. The other ones, you know, it is unknown to me what's the different probabilities. So there are many megawatts coming in all the time and coming out. If you see the pipeline of Iberdrola Renewables, you know, in the last three to five years, that number has continuously grown. So it's not a surprise, you know, when that review is done, there is no megawatts here or there, and you know, two months later, you know, there is, you know, some introduction coming into that, you know, assessment of megawatts. I think it's just, you know, our ongoing review that we do internally, and it will continue to be that. As soon as that information, you know, puts on the table certain priorities, even though there is no permit requested yet for this, you know, yet, even though there is no interconnection requested, so on, so forth, you know, once you become aware of that, for whatever reason, it has become part of the pipeline, then we just put it on the table. That's an ongoing process with it all the time.

Q. Well, as part of that process, when you decide to put these new projects on the table, do you consider things like the Public Service Commission's vertical market policy or other restrictions that may impact Iberdrola's ability to construct new wind projects that are interconnected to a transmission and distribution utility it's attempting to purchase?

A. (Mr. Azagra) I think that's a different question. Iberdrola, you know, there is in the company, they will always comply with policies or legislation in every single state, country, market, industry in which we do business. I think I will refer to the witnesses that we have, you know, that they will explain better what's the policy. It's my understanding, you know, based on the work we have done that, you know, the current policy will not stop us from doing this type of business. Again, I will refer to the witness, you know, to explain that in detail. And I think, you know, of course, we take into account, and we will continue to do so, every policy and legislation in every country or state in which we do business. Absolutely.

Q. But --

A. (Mr. Azagra) But the same legislation and policies change as well, and that's why, you know, to have pipeline is -- you know, this is a business that to develop parts takes three to five years. So I think, you know, in three to five years from now all things may change. So that's why, you know, what is more credible, you know, than other things will be decided over time. We cannot, you know, run the risk of perhaps things being different in some countries five years from now from a tax point of view, like what happens in Europe many times, and just, you know, saying, we're not going to focus there, because, you know, you cannot do certain things right now. No, we need to be there. You know, we need to continue to push for legislation, you know, to be different, you know, to develop the promotion of renewable energy. Within the United States, you know, we have a clear vision by the government and, you know, also in the other previous government, you know, supporting renewables in the States, and we like that.

Q. You mentioned in response to, not my last question but the one before it, that Iberdrola Renewables is an independent company. Iberdrola owns eighty percent of Iberdrola Renewables; does it not?

A. (Mr. Azagra) Correct.

Q. And is it fair to say that Iberdrola controls Iberdrola Renewables?

A. With an eighty percent stake, there are certain decisions that, you know, basically, we would have the majority taken.

Q. Iberdrola is not going to be out voted, right?

A. (Mr. Azagra) It sounds, sounds not. Additional review of the corporate government's, you know, documents we have put on the table in relation with the company.

Q. Going to the next part of that first sentence under the Joint Petitioners' Acceptance, it says, "Iberdrola will support and encourage investments by Iberdrola Renewables." Does the language "support and encourage" mean anything different than making sure that those investments happen?

A. (Mr. Azagra) Supporting means, you know, approving favor of developing of certain investments in certain regions, which is the case, as that is the case.

Q. And what projects did -- withdrawn. If you look at Exhibit 57 again, the first five projects listed were projects that Iberdrola was planning to develop before the merger was announced, correct?

A. (Mr. Azagra) The words "planning to develop," you know, with the understanding that they are in the pipeline with attention to try to develop them, yes. That is correct.

Q. What would be the investment for those projects if they actually were built? What would their cost be?

A. A rough number investment for megawatt in the U.S., you should think about probably around $2 million per megawatt, roughly. It could be 1.8, around that. I'm talking about, you know, the market consensus.

Q. So if these five projects end added up to 434 megawatts, roughly, the cost to developing them would be roughly $868 million by your number. Does that sound right?

A. (Mr. Azagra) Yes.

Q. So when the Joint Petitioners say that they will support and encourage investments of a $100 million, that's a level that's less than an eighth of what was already under consideration before the merger even was announced, right?

A. (Mr. Azagra) Before or during? It depends, you know, when the price becomes known. I think that 100 million, I think is, you know, a number basically to address, and we have reviewed it, you know, and I think I should refer to the witness that we have, you know, in relation to the past practice of how, you know, first interconnections have been approved. I think this is a specific commitment which, you know, we have decided to put it in this Partial Acceptance Document just to show Iberdrola's commitment, you know, to the state, and you know, share the views. Keep in mind that, you know, for example, if the tax credits were to be removed, or sorry, were not to be extended, you know, by your Congress and Senate by another year, we believe the number of megawatts to be built next year will be zero in the U.S. So, you know, as you can imagine, you know, Iberdrola, which has a track record of basically putting in targets and trying to comply with them, they have been very transparent, you know, and even when we say this is a commitment, we take it very seriously because we put our credit in delivering. And remember that, you know, this amount of megawatts are competing with other megawatts in other parts of the U.S. as well, but the final decision where to invest, you know, is not just whether these are the only assets. There are many other opportunities.

Q. I guess, one of the points I wanted to make is that the projects that could easily satisfy this $100 million commitment, there's plenty of projects outside of NYSEG and RG&E service territories that could be built that would still satisfy that $100 million commitment.

A. That's typical to say in wind business development. I think if you see the track record of projects becoming real, it's not so easy.

Q. Okay. I'll move on. So if the production tax credits are not renewed, this $100 million commitment in Exhibit 50 would go away.

A. (Mr. Azagra) Not necessarily. I think, you know, that's why you need to probably review Iberdrola's track record of complying, you know, with what they tell the markets or regulators, and basically, you know, we will make sure, you know, that we continue to comply with these proposals.

Q. So let's go through that part of the proposal again, because maybe I didn't understand it. It says that you'll make "investments in excess of $100 million in the development of wind generation in New York State within the next three years, subject to all necessary development permits and authorizations and provided that there is no material adverse change to existing fundamental economics of wind generation development in New York

State, e.g., values associated with PTCs, RPS and NYSEG market pricing." Do you see that?

A. Yes.

Q. Now, I interpreted that to mean that Iberdrola would not be bound by the $100 million commitment if the value of production tax credits changed; is that correct?

A. Legally speaking, that's correct.

Q. Okay. And so if -- and with respect to RPS, you're referring to the subsidy payments to wind developers?

A. (Mr. Azagra) Yes.

Q. So if the value of the subsidy payments under the RPS proceeding changed, Iberdrola would not be bound to the $100 million commitment.

A. (Mr. Azagra) That's correct. I was explaining that, you know, Iberdrola has a track record, you know, laying out capital expenditure and commitments in front of the markets and in front of regulators and governments, and I think, you know, here there is two different ways of looking into this. One is contractually. You know, we have to write it down that way. A different one is, you know, Iberdrola will intend to commit to the $100 million investment. Either through this way or another way, I think Iberdrola tries to belabor its, you know, announcements.

Q. Now, let's turn to your rebuttal testimony. Now, on pages three and four, you discuss, on the bottom of three to the top of four, you discuss some of the benefits of the proposed transaction. Do you see that?

A. (Mr. Azagra) Yes.

Q. Now, in discussing the financial strength, am I correct that the current Standard & Poor's credit ratings for Iberdrola is A minus and Energy East is triple B plus?

A. (Mr. Azagra) That is correct.

Q. And that's a one-notch difference, correct?

A. (Mr. Azagra) Yes.

Q. And approximately what's the spread between, the interest rate spread between A minus and triple B plus then?

A. (Mr. Azagra) Do you mean the spread on the debt?

Q. Yes.

A. On the finance, I mean, you know, it changes every minute. With the current market situation, you know, it has widened a lot, you know, a category spread versus a three B category. I cannot tell you right now which is the spread, but you know, I think probably you can think about, you know, tens of basis points of difference, you know, widening range in the spread, you know, between triple B category and A category in the recent, you know, period.

Q. And over the next say year, how much savings would be realized as a result of having a higher credit rating?

A. (Mr. Azagra) I think, you know, I would need some time to discuss that. You know, because first of all, I think this depends on the markets. I think, you know, the current expectation for the market I think is probably one of the basic examples for why we think, you know, a better rated company, you know, buying a worsely rated company is a benefit, a strong benefit. I think, you know, we have seen other cases in which, because of the contrary happening, I think, you know, there were some protections being put on the table. You know, the way we have it in the final deal, we believe it's a bench mark, you know, to have raised all equity for paying for the equity for this other company, you know, four and a half billion, you know, cash in equity. That's a huge difference in how to approach the matter. Going forward in terms of what you asked, very simple, I think, you know, the currency situations in the markets is not only a question of costs. It's a question of whether you get the money. I think, you know, there are many companies right now that they are going through troubled situations from a financial point of view simply because they cannot refinance their existing debt.

Q. Are you aware of any instances where Energy East has had trouble accessing the financial markets?

A. (Mr. Azagra) I'm not aware of that.

Q. Okay. So to the extent there are savings as a result of

Iberdrola's higher rating compared to Energy East, what is the approximate value of those savings for the next year or so?

A. (Mr. Azagra) Well, the way we work is, you know, that some of the agencies, they have a consolidated approach, so basically in the way they will do the rating of the books. Any subsidiary, they keep in mind those are ratings of the parent company. So I think, you know, that will be an enhancement to be taken into account. Every time there will be a bond of, you know, basically being refinanced or a loan, you know, should there be as well. You know, that will be the timing which you will benefit from enhancement. So it's not something that you can determine right now. It's something that -- you know, if you prepare right now to extend the bonds, probably there are some of them that are fixed rates, you will incur huge penalties. So it just goes as long as, you know, those bonds and loans have to be terminated. You know, what will be the enhancement, the spread differential that you will gain from basically being owned by a better rated company than you had before? That will be determined -- can we expect -- can we determine that right now? No, I cannot. You can make an assumption. You know, does the current spread increase? Well, you know, if you assume the agencies will treat this in a different way and the markets will see that, you know, you should be at the upper level of a rating rather than, you know, on the lower level of a rating from a spread point of view, that will be the differential you will get. That will be factored in over time.

Q. So if the savings are the spread between an A minus and a triple B plus rating company for either refinancings or new debt, would customers realize those savings before rates are reset?

A. (Mr. Azagra) It's not that it will have an A level spread, you know. The rating of the companies will probably remain as it is themselves. However, you know, the markets will take into account, because the agencies will have factored it in because they have already commented on that, and that's why there should be a mechanism in the spread. I think, you know, in terms of the other customers who would benefit from that, I would refer, you know, to how that's done in the rates and so on.

Q. Okay, before they address value. So what you're saying is your expectation is that Energy East or NYSEG and RG&E's ratings will not change as a result.

A. Could change, but I can't say it will change, could change, but definitely the spread, you know, is customary practice, and it can be, you know, analyzing debt. You know, we'll benefit from that.

Q. Okay. And so just picking numbers out, if we're talking tens of basis points, if debt is refinanced on July 1st, 2008, when would customers realize that benefit?

A. (Mr. Rude) When rates are reset and new cost of capital is developed for each company.

Q. So to the extent the company is able to save some money as a result of the merger through refinancings, isn't that kind of what's called a synergy savings?

A. (Mr. Azagra) Synergy is something you can, you know, justify right now with a number, if you have certainty of that. In the case of financing, there is no way we can guarantee something right now. It's impossible. Let's think about, you know, in a scenario since, you know, sometimes one of the parties refer to a worse case scenario, let's think about, you know, the other way around, a best case scenario. You know, the economy does look like it's going to get better. You know, employment is going to get better. Population is going to increase, you know, in the state, you know, everywhere. I think of them that it will not be a basically synergy or anything like that related to the transaction itself. You know, the spread will get better simply because the economy is getting better and everything is getting better. So there is not certainty right now you can put a number on that. It's a benefit that will come over time, assuming always, you know, several parties' approach, which is everything remains as it is right now.

Q. But let's take a different assumption. Say that there's a big spread in interest rates, and after the merger closes, the company is able to refinance a lot of debt. That would be savings as a result of the merger that would not go to customers until rates were reset. Isn't that the testimony of the panel?

A. (Mr. Azagra) If it works like that, that's correct.

A. (Mr. Rude) I think it -- and again, it depends on the company. You know, there's -- if in that scenario, which I'm not accepting necessarily because it's holding everything else equal, which I think was your question, you know, there are already sharing provisions for three of the companies that could capture that.

Q. Is the company over earning, NYSEG electric gas, RG&E electric and gas that the earnings sharing is already kicking in?

A. (Mr. Rude) The company doesn't, in our opinion, the company doesn't over earn. It earns, and then it shares what it earns if it achieves a certain structure.

Q. Let me be more precise, Mr. Rude. Has the earnings sharings mechanisms already kicked in for NYSEG electric gas and RG&E electric and gas?

A. (Mr. Rude) NYSEG electric does not have earnings sharing mechanism. NYSEG gas does, but it is not in a sharing -- the company is not sharing. Its earnings have not reached that level. That's in the rate plan. And RG&E electric has been in a sharing mode. It's in the process of completing its compliance files for '07 now. They'll be submitted later this month, and I would have to, I would have to refresh my memory on RG&E gas, but

I do not believe it's been in the sharing mode.

Q. Okay. So if we put RG&E electric aside, RG&E gas, subject to you're checking, and NYSEG gas, you have not yet hit the point of earnings sharing, and NYSEG electric, there would be no earnings sharing.

A. (Mr. Rude) That's correct.

Q. Did the company study how much savings it could realize through refinancings as a result of the merger?

A. (Mr. Azagra) No.

Q. Has the -- has Iberdrola made any commitment to higher performance standards for electric reliability if the merger is approved?

A. (Mr. Azagra) Say that again.

Q. Is there any commitment of Iberdrola to more stringent electric reliability standards if the merger is approved?

A. (Mr. Rude) No, there is no commitment to that higher standards.

Q. Is there any commitment for higher performance standards for service quality if the merger is approved?

A. (Mr. Rude) Nothing specific, no.

Q. Is there any agreement for higher or more stringent performance standards for gas safety or reliability if the merger is approved?

A. (Mr. Rude) No proposal.

Q. On page 4 of your testimony, line 11, you mention -- as mentioned, one of the benefits is maintaining existing utility jobs. Do you see that? Has Iberdrola agreed to maintain existing manpower levels at NYSEG and RG&E if the merger is approved?

A. (Mr. Azagra) Should I go ahead? What we have agreed contractually is that, you know, as a result of the merger, there will not be any change. I think, you know, basically as a policy, you know, we want to make sure that also the current standard, I believe, you know, certain quality, so forth, so on will remain there. You know, so from that point of view, you know, I think it will be that the management of the companies, they want to decide whether what you said is something that should be done or not, as they are doing right now. So there will be no change, you know, with past practice, and it will be a decision taken by the management of the company.

Q. So the management could decide to have layoffs following the merger?

A. (Mr. Azagra) You know, if you call that in the scenario, that's basically, you know, something we don't have basis right now. You know, we don't have any reason to envision that at all, and I would have to refer, you know, to whether the company on its own right now that, you know, they will basically see that's in the scenario going forward. Iberdrola has no reason to believe that's the case, you know, based on the information we have. And again, you know, I think that's unrelated to the transaction at all.

Q. No, but you're stating in your testimony that the proposed transaction supports economic development by maintaining existing utility jobs in Upstate New York. So what I'm asking is, is that a commitment by Iberdrola to maintain existing employment levels at NYSEG and RG&E?

A. (Mr. Azagra) The commitment we have here in writing is quite simple. Many mergers, you know, are based on layoffs, when they announce, you know, layoff problems before the deal is closed. Whether to get synergies or to get savings or even value to shareholders, whatever the reason you want, we concluded, based on previous cases and based on the current micro-environment you have in the state and, you know, in the U.S. as well, you know, that's not a positive thing in terms of announcing the construction. So that's why we agreed to what we agreed, which is because of the transaction, there is going to be, you know, no employment at all. You know, so we have agreed with that. No. If you're asking me, are we going to in the ordinary course of business, you know, the decision, I don't think Iberdrola is in a position to answer that right now. I think, you know, the current management should explain to you, you know, that whether Iberdrola is an owner or not of the company, the answer should be the same one. It's unrelated whether we become or not the shareholder, you know, the owner of the company.

Q. So two months after the merger closes, Iberdrola could decide to reduce manpower by ten percent. I know that's not your expectations, but you're not making any commitments that would stop you from doing that; is that correct?

A. (Mr. Azagra) That's correct. You know, the persons that will be taking those positions in terms of running the businesses are the management of the companies. So I think when you refer to Iberdrola, it should be, you know, more the utilities themselves, the ones taking the positions in the managements of those companies. I think, you know, we are committing to basically a lot of things here. So our expectation, you know, on information we have right now has nothing to do with that scenario you are describing there.

Q. Well, if that's the case, why doesn't the company just make a commitment right now to maintain existing manpower levels?

A. (Mr. Azagra) I think we're making, you know, several commitments to the State of New York, to the companies and to many other people, and this commitment of non-layoffs we believe is a bench mark at the announcement of the construction as compared to most, if not all, most of the construction going on in the State of New York and also in other states in the U.S. So

I think that's a huge benefit, in our opinion.

Q. And that's what I'm trying to explore, the extent of that, of what you call a huge benefit. You're saying no layoffs as a result of the merger; but the day after the merger or some period afterwards, you could have layoffs for some other stated corporate reason, correct?

A. (Mr. Azagra) Let's remember this is a first mover transaction, which, you know, it's very important to remember that. I think when, you know, you don't have any other utility operations in the state, in the region or in the U.S., and the only presence we have in the U.S. is through a separate company, which has been IPO'ed, so it's, you know, probably a situated company. You know, there is no merger there that is a vehicle, which we have agreed is going to a specific business. That's it. So basically, you know, the only platform, the only head we are going to have in the U.S., you know, is going to be Energy East should the deal be approved. So from that point of view, I think it's quite easy to see that, you know. I don't think the scenario you are describing is what is customary with respect to this type of first movers into an across boarder, Trans-Atlantic transaction.

Q. Let me ask the question this way, and then I'll move on, I guess. To the extent that Iberdrola decides sometime after the merger to reduce employment levels by some amount, isn't it true that customers would receive no costs savings related to that until rates are reset?

A. (Mr. Azagra) Again, I will make sure that it's not Iberdrola. It will be the management of the utilities taking the ordinary course of business decisions in terms of, you know, the question.

A. (Mr. Rude) Mr. Mager, I think you can read this commitment as that the transaction is, unlike other transactions perhaps, the transaction itself will not result in job losses, and that's the commitment, and that's Energy East's understanding of Iberdrola's commitment, and that's what's being communicated to employees. There could be circumstances that could arise in the future that neither of us can identify that might result in the change of employment levels, but that change could be upwards. So I think the commitment is that the transaction in and of itself will not change job levels, and that's a substantial commitment compared to other transactions.

A. (Mr. Azagra) I think, you know, remember Iberdrola's track record everywhere we go. You know, I think our track record is to do as much business as we can, and right after we go into any market, any state, any country, I think, you know, three, four, six months after we start, you know, having operations there, we just really come back with a strategic plan. Capital expenditure, you know, is key for us, opportunities to invest. I think, you know, that's the track record we have. You can review that in Mexico. You can review that in the UK. You can review that in Spain and just, you know, go country by country. So I think from that point of view, I think Iberdrola's approach to this transaction basically to acquire, you know, this company and just optimize it as much as you could, no. You know, this is the platform in which we want to do much more business in the state, of course, and in other parts of the U.S. if possible. But definitely, you know, that is the approach we need to concentrate on that is proper. We do need to do more.

Q. Okay. Can you just explain to me how these decisions are going to be made, because two questions ago when we were talking about employment levels after the merger, you were saying, you know, it's not up to Iberdrola. It's up to existing management. And now, you're saying this is the way Iberdrola does things. Aren't all these decisions ultimately -- aren't we talking the same thing? After the merger isn't existing management part of Iberdrola?

A. Absolutely. I mean, it would be -- you know, I think the way I think it sounds to me, you refer kind of like Iberdrola is separating that from Energy East or management or new management in the future, you know, running the company. Absolutely not. The local management, that's the approach we have to run the companies and take care of the decisions. I think, you know, whatever part of the company, we support decisions being taken by the management. We think, you know, they are fair by any management of any, you know, subsidiary we have within the group, whether it's in Spain, in the UK, in Greece or in Mexico or in the U.S. I think from that point of view it's important, you know, basically, the culture that we have. In the terms of investments that I mention right now, that's a different thing. I think, you know, the location of resources within the group -- that's taking, you know, the holding company. So from that point of view, you know, it will not increase investments in any region. That has to be a group decision, and that was what I was referring to in my previous concept.

Q. When you talk about being a first mover, what exactly do you mean by that?

A. I think it's how many other constructions have been approved. In New York, you know, we don't have any existing utilities in New York. So we are not merging to existing companies in New York. You know, we are just doing a straight purchase of shares of a company which is a utility in New York or in the region. That's it. We're not merging existing utilities either in New York or in the states around New York.

Q. And Iberdrola didn't have any existing utilities in Scotland, right, or England or in any of those areas?

A. (Mr. Azagra) No, it did not.

Q. Was the Scottish Power acquisition a first mover?

A. (Mr. Azagra) Yes.

Q. And in that case, not only were there synergy savings, but I believe Staff stated in its testimony on page 58 that the synergy savings were double of what was originally estimated. Do you question that?

A. (Mr. Azagra) It is not a statement that we have committed to achieving. You know, that's an estimate, but that's what it is right now.

Q. So synergy savings still can be realized through first mover transactions?

A. (Mr. Azagra) Initial review, you know, the disclosure of those synergies within the different businesses for Scottish Power, you will find, you know, we're talking about three million, only three million in the T&D businesses. I think, you know, if you review the IT, you will see they have SAP, which is the main driver of those synergies. So I would encourage you to review the detail of those synergies.

Q. Did Iberdrola ever perform studies to identify and quantify possible synergy savings with respect to this merger?

A. (Mr. Azagra) Scottish Power or --

Q. No, Energy East.

A. No, we did not.

Q. Why did it decide not to even conduct any studies to see if synergy savings were possible? Wouldn't that be something of importance to consider?

A. (Mr. Azagra) I think, you know, the way this transaction has been presented to the market, as we always try to do, is a very transparent move. I think, you know, we have been criticized, you know, by some experts, some analysts, Why are you doing this contractually? You know, there are no up-front synergies that you can explain to people. Well, that's the case for many mergers going around the world. I think, you know, it's not strange to say this is, you know, the first move, and then, you know, we get familiar how the regulatory frameworks work in the U.S. from a political point of view, and we'll go from there. You know, that's how we moved into Brazil. We went first into regulated business, and then, you know, when we were comfortable, you know, with overall regulation within the country, then we started doing other businesses. So I think that's very, you know, clearly explained and not strange.

Q. So what you're saying is, there may, in fact, be synergy savings, lots of synergy savings. You just don't know them now.

A. (Mr. Azagra) I would not refer to synergy savings. I would refer, you know, to best practices at most.

Q. Well, you're saying you don't want refer to synergy savings but --

A. (Mr. Azagra) No. If we were of the thought that, you know, this is a deal, you know, we could have thought about synergy savings, we would have put that on the table, absolutely.

Q. Wouldn't it have made sense in considering the deal to investigate whether there were synergy savings?

A. (Mr. Azagra) Well, I think, you know, when you have experience of doing this business for more than a hundred years, when you've got, you know, construction in Europe with -- we go over $30 billion in the UK. It's over a $30 billion amount involving the transaction, and the synergies that we analyzed in that company, you know, in the regulated business are three million, you know, I think, you know, probably it's kind of strange that our investors would agree with us that this is not a synergy driven transaction action, as many other cases in New York has been treated like that and acknowledged by, you know, what I understand -- I will refer you to our experts on that and the witness, but that's something that has been acknowledged with other transactions, in different transactions.

Q. What is your understanding of how New York treats synergy savings in merger cases?

A. (Mr. Rude) Well, again, in our, you know, limited experience, you know, it can vary, but generally, there's been a sharing, but usually the burden is on the company to find them. So there's generally an up-front realization of the synergies before they are achieved.

Q. And wouldn't you agree with me that the Petitioners have an incentive, financial incentive to minimize any identified synergy savings prior to the transaction?

A. (Mr. Rude) Well, I can say in support of Mr. Azagra, it was not a focus of the transaction. The synergy savings and potential that I'm familiar with is associated with duplicative functions, redundant functions between companies where you're doing a combination, and that wasn't the case here.

Q. Now, with respect to the merger, is there a possibility that Iberdrola will realize certain benefits from production tax credits?

JUDGE EPSTEIN: I'm sorry. If we're going onto a somewhat different subject, let's have a discussion about scheduling off the record.

(A brief recess was taken.)

JUDGE EPSTEIN: We're back on the non-confidential record, and in between closing the confidential record and opening this one, we had an off-the-record discussion about the confidentiality portions of the confidential record and that discussion resolved those issues. So I would assume that what we would like to do at this point is to continue with Mr. Mager's cross.

MR. MAGER: Thank you, your Honor.

Q. Can you please turn to page 66 of your rebuttal testimony. On that page the panel discusses the Rochester transmission project or RTP. Do you see that?

A. (Mr. Rude) Yes.

Q. Now, what was the justification for the RTP?

A. (Mr. Rude) Shut down the Russell Station. Excuse me.

Q. And explain why the RTP was needed if Russell Station was shut down.

A. (Mr. Rude) I believe that's covered in some detail in some interrogatory responses, but it's really not having that generating source, actually a multi-unit generating source in the load center, required the T&D infrastructure in that area to be reinforced in the event of a shutdown, that contingency.

Q. When was the RTP approved approximately?

A. (Mr. Rude) Fall of 2004, subject to check.

Q. And when did construction start on the project?

A. (Mr. Rude) Soon thereafter.

Q. And is it your testimony now that the RTP project does not satisfy the reliability need that it was justified?

A. (Mr. Rude) No, just the opposite. Russell Station is scheduled to be shut down shortly, and the area would not have sufficient reliability without the RTP project. So, in fact, it's essential once Russell shuts down.

Q. And does the RTP satisfy any reliability needs for that region of the service territory?

A. (Mr. Rude) Yes, the shut down of Russell Station.

Q. Okay. Can you please explain to me the sentence starting on line 13 of page 66 where you state, "The Rochester system has experienced additional growth since that time, and RG&E has identified a localized reliability need within the system that cannot and was not designed to be met by the RTP."

A. (Mr. Rude) Yes, that's looking out into the future beyond the shutdown of Russell Station, and also the ISO has identified in Zone B the need for more reinforcement in about a five- to six-year time frame.

Q. And how much growth has the company experienced since approval of the RTP in that region?

A. (Mr. Laurito) Yeah, I don't think we can speak to that type period specifically, Mike, but we can say that the peak load growth since 1999 approaches 30 percent.

Q. How much has peak load growth -- how much has peak load grown since the RTP project was approved, and how much has it grown above what the company projected at that time?

A. (Mr. Laurito) Don't know.

Q. Is the RTP project complete?

A. (Mr. Laurito) No.

Q. When will it be completed?

A. (Mr. Laurito) In May of 2007 or May of 2008, excuse me.

Q. And is it on budget or above budget?

A. (Mr. Laurito) It is on track with the contracted price that was established.

Q. Was the contacted price that was established the same as the price estimates at the time the regulatory approval was sought for the project?

A. (Mr. Laurito) I'm not sure. I'd have to double check. I don't have that with me.

MR. MAGER: Okay. I'd like to make an on record request for the projected cost of the RTP project when it was proposed to the Commission and the projected cost of the RTP project now according to the company's best estimate.

MR. FITZGERALD: To the extent that doesn't call for any study, we'll provide that data.

MR. MAGER: Thank you.

MR. VAN RYN: Your Honor, I believe that there is projected costs right in the Order approving the RTP project.

Q. Is that the cost that the company still believes is accurate?

A. (Mr. Laurito) I'm not sure what costs you're talking about.

MR. VAN RYN: It was in the RTP Order approving the project. There are estimated costs of what it's going to cost, a dollar-for-dollar figure. Now, it could have changed. I suppose you could state that it changed later, but that is a projected cost that was in a Commission Order.

JUDGE EPSTEIN: So, Mr. Mager, are you requesting something that might be different from that?

MR. MAGER: No, I'll keep with my original request, and I can always look up the Order if I need to.

Q. Let me just change gears now. I think we just have one or two more topics and I'm done. Production tax credits or PTCs, is it Iberdrola's position that it will not realize any financial benefit as a result of the merger with respect to PTCs?

A. (Mr. Azagra) Are you referring to a specific line or --

Q. Sure. Let me direct you. I believe starting on page 28 and continuing through page 36.

A. (Mr. Azagra) Tax credits is in making the same to enhance renewable energy being developed. As you know, it has been provided by the federal government in taxable income credits or exemptions or whatever the right word, you know, has to be. So it's totally unrelated to the transaction itself, you know, whether there was to be the construction, that we be there. It is part of those mechanisms that allow basically the economics of wind development to be there. So should those, you know, enhancements not be there, you know, there would be no wind being developed.

Q. The production tax credits are used to offset income; are they not?

A. (Mr. Azagra) For people that have income, they can benefit from that.

Q. Is it possible that Iberdrola would use income realized, income earned by Energy East to maximize the tax benefit of a production tax credit?

A. (Mr. Azagra) Any income you were to have in the U.S., is not a specific of this transaction with this company. You know, subject to the tax credits being there, which, as you know, still have not been renewed for next year and basically relate to the transaction, so it's a condition in parenting to the economics of those projects, otherwise they will not be developed.

Q. And you believe that the opportunity to utilize production tax credits are unrelated to this merger?

A. (Mr. Azagra) It's not unrelated. You know, I think, you know, any potential income that you were to have would allow you to benefit for whatever the federal government has decided to do in order to enhance the type related to any, you know, issue with ratepayers or anything like that. I think, you know, however, from our point of view, when you move into evaluation of Energy East, we did not and we do not take that into account, because it is not certain. There is no certainty that it will be there.

Q. And if it was there, that would be a synergy savings; would it not?

A. (Mr. Azagra) No, it would not.

Q. It would be a benefit realized by Iberdrola as a result of the merger?

A. (Mr. Azagra) I would not define it as a benefit. It's something that, you know, the federal government has decided which is not related to the public formation or the rates being set up or anything like that.

Q. Let me ask it this way: Wasn't the ability to utilize production tax credits one of the motivations to acquire Energy East?

A. (Mr. Azagra) It's one of the items that was addressed, you know, that it had to be analyzed, and subsequently, when it was analyzed, basically we came to the conclusion there is no certainty that will be there, and that's why it didn't become a driver for us, you know, going forward. It was one of the initial items that was identified that should be analyzed by us in order to be put in the position of this investment in the transaction and the development of wind energy in the U.S.

Q. And do you agree that in presentations concerning the merger, Iberdrola cited the production tax credits as one of the benefits and motivations for the merger?

A. (Mr. Azagra) In the initial presentations, yes, we did.

Q. And when you say there's no guarantee or certainty that the benefits will be there, would you also agree there's no certainty that the benefits would not be there?

A. (Mr. Azagra) Again, I would not define it as a benefit, you know, related to the transaction, you know, in relation to the Public Commission, rates being paid by the ratepayers or anything like that. I think it's, you know, it's basically a mechanism at the federal income level. So any distraction from that objective basically will result in not building it.

Q. Well, let's assume that the production tax credits are renewed. What is the maximum financial benefit that Iberdrola could realize from those credits along with its acquisition of Energy East?

A. (Mr. Azagra) We have not done anything on that analysis. I think it's related, you know, to the tax credits being there, which is not the case right now since they have not been renewed. Second, you know, Iberdrola Renewables as a separate entity has been using tax equity investors till right now. So from that point of view, should Iberdrola have taxable income, they will have to process, you know, also to be the tax equity investor.

Q. What are the -- what are the Spanish tax benefits that you address in your testimony? Can you explain what those benefits are?

A. (Mr. Azagra) We don't address any benefits, you know.

Q. Your position is that there are no benefits, but what I'm asking is, what are the potential Spanish tax laws that could be taken advantage of as a result of the merger?

A. (Mr. Azagra) I think it's very similar, you know, to the tax credits. I think, you know, we believe, you know, any transaction that we could do, you know, if there is no federal government, in this case the Spanish government, that they want their taxpayers basically to produce, to provide some type of extension on some items. You know, it's unrelated to this transaction or any other that we are doing anywhere. However, if the tax mechanism that you refer to is related to amortization of the financial good will, related to the purchase in relation to investments of Spain --

Q. Like Energy East.

A. (Mr. Azagra) I was going to go into that.

Q. Okay.

A. (Mr. Azagra) I think, you know, there are two important things there. The first one is a tax deferral. So basically, you know, it's something whenever you were to sell those assets, you will incur payments and you will have to pay for that. So it's not forever an exemption. The second one will be, you know, from a cash point of view, it's there. So we just put aside the money. So it's not something, you know, from a cash point of view that we enjoy, and also important is based on the rulings that, you know, the government has done, and again, it is something that the taxpayers in Spain are happy to do, but you know, it's the case, you know, analyzed under the rules of the tax authorities in Spain that you will not enjoy these if you were to acquire a holding company. It's done with intent when you acquire assets, when you acquire businesses but not when you acquire holding company. So that's why also from an evaluation point of view, there's a difference from, you know, Scottish Power, as an example. We came to the conclusion that that was not going to be, you know, the case, and we didn't take that into account in the evaluation of the company.

Q. Let me direct your to page 36 of your testimony, line 16. You state that, "There is no certainty that Iberdrola will ever be able to obtain any tax offset or good will amortization associated with the proposed transaction under Spanish law." Do you see that?

A. (Mr. Azagra) Yep.

Q. Now, is there a certainty that Iberdrola will not be able to obtain any tax offset or good will amortization?

A. (Mr. Azagra) Our belief is that according to the current case reviews that they have done, by acquiring a holding company, we will not be able to benefit from that.

Q. But at this point you're not sure yet?

A. (Mr. Azagra) I cannot be sure, you know, because it's something that the tax authorities have to rule when there is something on the table. So until the transaction is not closed, there is no certainty for us at all, and even in the transaction they have to review that.

Q. So what would happen would be after the transaction is closed, Iberdrola would make some sort of filing with the tax authority?

A. (Mr. Azagra) What historically has been the case with investments is we file our requests for them to understand whether, you know, we fall within the category or not, and then you know the taxpayers are happy basically to defer this tax issue, but you know, their rules are there.

Q. And if Iberdrola was to make such a filing, it would seek favorable tax treatment?

A. (Mr. Azagra) Absolutely.

Q. And if favorable tax treatment was granted, would any of that flow to the customers of NYSEG and RG&E?

A. (Mr. Azagra) We think, you know, in that scenario that is not fair, you know, basically to move what taxpayers are happy to do because of the government in another country, you know, to unrelated rates being set up in another business, we think are totally unrelated matters.

Q. So you're saying U.S. customers cannot take advantage of

Spanish tax laws, but Spanish companies can take advantage of the United States' production tax credit?

A. (Mr. Azagra) When you invest, when you invest and then produce energy, then you benefit from that. So I think your comment is totally unrelated.

Q. Isn't the Spanish tax law specifically for investments?

A. (Mr. Azagra) For any company?

Q. In other countries.

A. (Mr. Azagra) For any company based in Spain, not a Spanish company, any company based in Spain, and again, it's a tax deferral. So don't call it tax benefit.

MR. MAGER: I have nothing further. Thank you, you panel.

JUDGE EPSTEIN: Okay. Other cross?

MR. BREW: Yes, your Honor. Since Mr. Mager has covered everything that I pretty much planned to get to, this will be very brief.

CROSS-EXAMINATION

BY MR. BREW:

Q. In your rebuttal testimony on page 9 under the heading, "Economic Development and Jobs," you state that the proposed transaction will reinforce ongoing efforts to maintain and revitalize the economy of Upstate New York." Do you see that?

A. (Mr. Azagra) Yes.

Q. "Ongoing efforts," does that refer to ongoing efforts by the Energy East companies or some other efforts?

A. (Mr. Azagra) We could expand that to some other efforts.

Q. Would it include efforts by the Energy East companies?

A. (Mr. Azagra) If there are specific projects, absolutely.

Q. On page 16 of your testimony at line 16, you indicated that, "Finally, the Joint Petitioners wish to emphasize that reliability, safety and customer service will remain top priorities for both NYSEG and RG&E after the consummation of the proposed transaction." Do you see that?

A. (Mr. Rude) Yes.

Q. Is support for efforts to maintain and revitalize the Upstate economy also a top priority for the Energy East companies, and if so, would remain so after consummation of the transaction?

A. (Mr. Azagra) I mean, we are not a government. So, you know, we are not the people that set up policy and basically focus in one region or another one. I think, you know, what we have a track record of is of investing, and I think the type of investments that Iberdrola has done in the past -- and I want you to make sure that people understand the track record -- coincides with the type of investments you need in a specific region of the state. So we think, you know, we are the right player to come into New York, and that's basically the reason why we are very comfortable focusing on New York when compared to going something else.

Q. My question was, do the Energy East companies have a role now in helping to support economic development in Upstate?

A. (Mr. Rude) Through our rate structure, we certainly do, both to retain or to provide alternatives to contested load and also to provide incentives for companies willing to invest and grow their businesses and load in the service territory.

Q. Okay. Thank you. And you've got multiple references to the importance of economic development in your testimony, specifically, on pages 4, 9 and here on 16. So my question is, following the consummation of the proposed transaction, will the Energy East companies remain committed to supporting economic development as a priority?

A. (Mr. Rude) Yes, in the manner I just spoke about.

MR. BREW: Thank you. That's all I have.

JUDGE EPSTEIN: We'll have a discussion of scheduling off the record.

MR. DUTHIE: Your Honor, I have cross-examination, too.

JUDGE EPSTEIN: That's fine. That's what I want to talk about. You have -- I'd like to get us out for lunch around 1:30. So can you please say you've got more than 15 minutes worth? I'm just wondering whether to break for lunch now. And Mr. Prestemon.

MR. PRESTEMON: As with Mr. Brew, Mr. Mager asked most of the questions I wanted to ask, but I might have 15 or 20 minutes at the most, and I do not want to have the pressure of being the one that's holding up lunch.

MR. DUTHIE: And your Honor, as a result of Mike's questioning, I have a couple of follow-ups.

JUDGE EPSTEIN: All right. So what do you say it's lunchtime now?

MR. PRESTEMON: Yes, sounds good.

JUDGE EPSTEIN: Okay. We'll be back in one hour.

(Discussion off the record.)

JUDGE EPSTEIN: Back on the record, we just had a discussion such that we are adjourning for one hour.

(A luncheon recess was taken.)

JUDGE EPSTEIN: Other parties have cross for this panel.

MR. PRESTEMON: I do, Your Honor.

JUDGE EPSTEIN: Sir?

BY MR. PRESTEMON:

Q. As I said earlier, Mr. Mager covered most of the questions so I have a few follow-ups to his questions and just a few more.

First of all, on your discussion of your commitment to sell the fossil fuel generation in RG&E's territory, as I understand the partial acceptance, you are imposing only two conditions on that sale: That only the proceeds in excess of book value be shared with rate payers; and that all the proceeds from the sale of the Carthage peaking unit go to shareholders; is that correct?

A. (Rude) Gains or losses.

Q. Gains or losses. Those are the only two conditions and otherwise you say that you will accept reasonable protocols established by the Commission, correct?

A. (Rude) That is correct.

Q. So --

A. (Rude) As well as a determination of where the proceeds go.

Q. You are committing now to abide by -- subject to those conditions -- to abide by the determination of the Commission on the protocols in all other respects; is that correct?

A. (Rude) That is correct.

Q. If either or both of those conditions is not incorporated in the decision by the Commission in this case, would you consider that fatal to proceeding with this transaction -- I guess this would be a question more for Pedro -- or merely a negative factor?

MR. FITZGERALD: Can you repeat the question again?

BY MR. PRESTEMON:

Q. I am asking: If the two conditions that you are asking for on the sale of the fossil fuel-fired units are -- either one or both is not incorporated in an order in this case by the Commission as accepted conditions, would you consider that fatal to your decision to proceed with the transaction, or merely a negative factor that you would weigh against all other provisions of the order?

A. (Rude) I think we'd wait to see whatever changes were made before we made any kind of decision like that. However, it's hard for us to imagine that the Commission wouldn't accept these two conditions.

Q. That's fine.

I would like to explore a little more the limitation that you have on your commitment to renewables. I'm just trying to determine to what extent this is a binary condition -- on or off -- or whether there is some nuance to it.

You state that, if the Commission imposes restrictions on your ability to develop renewables, that might cause you to withdraw this commitment. If a decision by the Commission imposes some sort of restrictions that inhibits you in some areas or maybe makes certain projects infeasible but leaves most of the others available for you to develop, would you still consider your commitment to have been withdrawn?

A. (Azagra) I think one of the reasons why we are here is because of the development of energy and wind energy in New York. So if there was to be any restrictions to that, I think that would apply to this concept.

Q. So, if the Commission determined that Iberdrola should not develop wind power that interconnects with the facilities of NYSEG or RG&E, then you would consider this commitment to be withdrawn; is that correct?

A. (Azagra) Absolutely.

Q. And if there were a change in the RPS program or the federal tax credits or any other economic factor governing the development of wind power such that some of the projects in New York would not be as attractive -- let's say not unprofitable but not as an attractive as additional wind projects on the north coast of Scotland or Bolivia -- would you consider that to have caused this commitment to be withdrawn?

A. (Azagra) It could be one of the reasons as well.

Q. Are you aware that the -- I think it's been mentioned a few times -- that then-Lieutenant Governor, now Governor of the state headed a task force that investigated the development of renewable energy in the state?

A. (Azagra) Partially aware.

Q. In his report, he suggested that the State of New York, in addition to the development of wind power itself, needs help with education and training of personnel to operate and construct these facilities and also needs investment in the manufacturing of equipment for the generation of wind power.

Would Iberdrola be willing to make a commitment to expenditures in areas such as that?

A. (Azagra) I think, as part of economic development that we do with wind development, that we have done in many countries -- especially the first part of your comments, the one referring to training people and using local sources to develop facilities to be able to construct and so on -- that's the case. That's something, you know, that has been done. It's done. So that's one of the basically reasons why we are local because that's something that brings wind development with it, that specific comments that you said.

Q. Are you willing to make a commitment to those types of expenditures, now, in this case?

A. (Azagra) I think that comes with wind development. I think there are companies and there is a queue of potential development. I think we've seen that queue in many countries and in the States. I think Iberdrola brings reality to projects and commitment in developing them. Once we come to the conclusion that New York is there, probably the experience of Spain, where we took care of more than 50 percent of the renewable targets when Europe and the UK being the No. 1 development of wind and you're looking to the US No. 2 -- here No. 1 in the world -- seems to us that's the best credentials for the type of companies you want to do business in New York. We don't go into states not to do anything.

Q. So, effectively, if conditions occur that cause you to withdraw your commitment with respect to the construction of wind power generation, that would also withdraw any commitment you might have to training, education, or construction?

A. (Azagra) Everything is linked and we are happy to share our experience in all the other countries where we are either the No. 1 or No. 2 operator and developer at the same time.

Q. And now just a couple follow up questions --

A. (Azagra) You can find even public pieces, public news, where it has been described the importance of wind and the economic development behind wind. In many countries, that has happened already. That's something that is findable, not just theory. It has been proven already, so that's quite an interesting area, the one you are raising.

Q. Couple follow-up questions to Mr. Mager's question on jobs.

If I understood what you said in response to some of Mr. Mager's questions, Iberdrola currently has no plans associated with the consummation of this transaction to make any major reductions in staffing at any of the regulated utilities in

New York State; is that correct?

A. (Azagra) Not major. None at all.

Q. Even better.

I think you also said that day-to-day, month-to-month, year-to-year decisions concerning staffing, it was Iberdrola's intention to leave that to the management in place at Energy East?

A. (Azagra) Affirmative.

Q. Okay, so, then moving to Energy East -- I said I'd ask Energy East: Do you have any plans currently to make any major reductions in staffing as a result of the consummation of this transaction?

A. (Rude) No. None at all.

Q. Have you done any studies or analyses to indicate that any such reductions might be possible?

A. (Rude) I certainly can ask Jim to comment more on that, but we know what our staffing is and where it was, and as we have provided in this proceeding that's come down over time for some reasons related to the synergies between the two companies and also the formation of service companies where employees left the utility companies but came to the service companies.

We think we reached a point where that's got to head in the other direction, frankly, and particularly to meet the capital program needs that we have and just to maintain service quality in the territory. The comment I would add to that, Dave, is no, we haven't done any studies.

Q. Given that, is there any reason why the companies Iberdrola and Energy East could not make a commitment now that no such major reductions are going to take place in the next three years?

A. (Azagra) I think, as to Iberdrola, the basic approach we have to the businesses is: Businesses change over time for the good and for the bad, and regulations change, and governments change. And there are many things you can not guarantee that would be out there right now in the future.

One angle that is important is the track record of Iberdrola in relation to human resources and labor relationships. We provided information about the trade unions representation and collective agreements that we have in Spain. How that approach is also done in the UK. That's probably the track record we have, one of the things that we feel very comfortable, which is a very long track record, a complete agreement. Many steps are taken in the companies from an HR point of view with the workers' representatives.

There have been no unilateral decisions being taken by the management in the Company, at least as long as I can remember since I joined. That's probably the best example and demonstration of the culture that we bring, which is basically everything being done through agreements.

Q. Now, in an effort to save some time here, if I were to ask you that same series of questions I just asked about staffing, with respect to reductions in staffing, if I were to ask you that concerning relocations of utility personnel out of the State of New York, would your answers currently be the same? That is, if Iberdrola has no immediate plans, Energy East has no immediate plans?

A. (Azagra) I think, as Iberdrola, we committed in writing, again, some transactions happening in the US which involved different states, different companies headquartered in different states, and the headquarters being a big issue for the regulators and Commission approving the details. We committed to maintaining the headquarters where they were. That's another tool for making sure people understand we want to remain local. That's something we have put in writing in the merger agreement.

(Rude) The changes in location for utility employees was really related to the service companies. I mean, we haven't moved NYSEG and RG&E utility employees to Pennsylvania. You wouldn't do that. So, that service company development and transfer, that's already occurred. That won't happen again.

Q. And finally, with respect to the location of facilities in New York State, are your answers essentially the same: There are no plans to make any major changes?

A. (Rude) No, there is no plans other than the capital additions that we proposed.

Q. I am sorry to be jumping around, I missed one back on the renewables commitment.

You were asked about the meaning of the undertaking to support and encourage development of renewables. I believe Mr. Mager brought out the fact you own 80 percent of the stock in Iberdrola Renewables.

Is there any reason why Iberdrola, the parent company, can not direct its subsidiaries to undertake these investment?

A. (Azagra) Would you mind to repeat the question?

Q. I am just asking: Given your control of the stock of Iberdrola Renewables, is there any reason why, in furtherance of your commitment in your partial acceptance, you can not direct the development of renewable energy projects, rather than merely support and encourage them?

A. (Azagra) We have in the agreement signed between Iberdrola Renewables and Iberdrola parent company. Iberdrola Renewables has become the exclusive vehicle for any renewable development within the group. So no other part of Iberdrola can develop -- any development of wind or other renewable source of generation will be done through Iberdrola Renewables. Legally speaking, since NYSEG's a publicly traded company, we can support. Being the 80 percent majority shareholder, that explains how comfortable we are that that would be done. We need to say it in that way.

Q. So, in effect, you can direct Iberdrola Renewables to go forward with these commitments?

MR. SCHWARTZ: Objection, Your Honor, Mr. Prestemon is asking a question that he's already asked. While I have no objection to the quality of the question, it seems like he's looking for a legal determination with respect to the corporate structure powers that Iberdrola has over Iberdrola Renewables. I believe that, as a witness, non-lawyer in this proceeding, that Mr. Azagra has already answered that.

JUDGE EPSTEIN: I didn't quite understand the witness' answer. I couldn't hear.

You were saying that there is a publicly held company. You are referring to Renewables, not -- you weren't talking about Iberdrola?

A. (Azagra) No. We placed in the market, through a capital increase, 20 percent of the Company back in November.

JUDGE EPSTEIN: And so was your answer that, because of the 20 percent, Renewables is an autonomous company and Iberdrola cannot direct it to take certain actions?

A. (Azagra) Taking into account the legal obligation, I would refer to lawyers for that. I think the word "support" means we can vote and we can basically, through our vote in the Company, promote the direction of investments and other things that we would have to vote for. That's why we were using the word "vote" or "support."

BY MR. PRESTEMON:

Q. All right, is the meaning of your commitment as set forth in your partial acceptance that you will encourage and support the development of these renewables through the exercise of your upstream voting power? Is the meaning of that commitment that you will vote your shares to have Iberdrola Renewables carry out this commitment?

A. (Azagra) What the legal means that we would have to put in place in order to comply with this commitment.

Q. I hesitate to ask this because I don't know if this is a legal question either, but: Do you know of any reason why Iberdrola could not have this matter considered by Iberdrola Renewables so that you could vote on that?

All right. What I am trying to get at is: Do you have the power to make this happen? Or do we need Iberdrola Renewables in the room here to assure ourselves that something is going to happen?

A. (Azagra) I think we are putting here because Iberdrola is taking the obligation to comply with this. We are running the risk of complying or not complying with that.

Q. And if, for any reason, Iberdrola does not comply with this commitment, what will be the recourse of those of us -- parties who have supported the inclusion of this commitment -- in the decision of the Commission?

A. (Azagra) I don't think that's a scenario we envisage.

Q. I know, unfortunately. I don't want to envision it but --

A. (Azagra) I think if you review our strategic plan in which we highlight, as Iberdrola, which are the targets from our renewable point of view, the vehicle to implement those targets is Iberdrola Renewables. But I think we have our target as a group and the vehicle is Iberdrola Renewables. This obligation, as the targets for Iberdrola, are part of Iberdrola's strategic plan. That's why we have the targets and the vehicle is Iberdrola Renewables.

Q. Let me ask a couple of questions on the vertical market power issue.

At pages 20 and 21 of your rebuttal testimony, I believe you state there that it is your opinion that the testimony of Dr. Hieronymus demonstrated vertical market power should not be an issue with respect to wind power development by Iberdrola; is that correct?

A. (Azagra) That is my opinion. I will refer to other witnesses to explain in that detail, but that's my understanding.

Q. But are you familiar with your witness' testimony because you've cited it there?

A. (Azagra) Yes.

Q. Is it your understanding that the wind power development by Iberdrola should not be considered to raise vertical market power concerns either because this type of development would not give you the power -- would not enable you to exercise such power or that reasonable mitigating conditions could be imposed to assure that vertical market power could not be exercised?

A. (Azagra) I think I should refer to our local counsel or the experts that we are bringing. They know the market power policy of the state. As Iberdrola, we do not believe that there is any market power with wind development anywhere. Not only in New York, but anywhere else where we're doing business.

That's our own opinion. It's a very firm opinion. We don't think any limitations to that. We don't think there is any mitigations that should be required. That's our clear opinion for that.

Q. Are you familiar with the vertical market power policy statement of the Commission in the state?

A. (Azagra) I would refer to our counsel or experts in detail for that.

Q. So, you do not understand, yourself, what that policy would require?

A. (Azagra) It's our understanding that there is no market power issue in the development of wind in New York by Iberdrola's subsidiary Iberdrola Renewables should we acquire these utilities.

Q. I understand what your position is, but I am just asking if -- maybe I have asked it already.

You are not familiar with the terms of the Commission's policy statement?

A. (Azagra) I will say it again: My understanding is that there is no conflict with any market power in the state of New York by developing wind.

Q. Does anybody else on the panel have a familiarity with the terms of the policy statement?

A. (Rude) I have familiarity with the terms.

Q. Mr. Rude, do you understand that the policy statement says that there is a rebuttable presumption that vertical market power could be exercised by a transmission owner that also owns generation facilities?

A. (Rude) Yes.

Q. And that presumption can be rebutted by a showing either that vertical market power cannot, in fact, be exercised by the owner, or that reasonable conditions can be imposed that would mitigate the exercise of that power?

A. (Rude) I think that's a fair paraphrasing.

Q. As I understand it, the witnesses for the companies in this case have said that their opinion is that it is the case that -- either with wind power development by Iberdrola, that either no market power could be exercised or that reasonable conditions should be imposed that would mitigate against the exercise of that power, correct? And you have cited that in your testimony?

A. (Rude) That is correct. I think we are also encouraged by FERC's ruling on this in approving the transaction.

Q. Given that, is there any reason why the Company cannot now commit that they are willing to be bound by the Commission's policy statement as that policy statement may change from time to time?

A. (Azagra) Iberdrola would comply with an existing or future policy ruled by the Commission as we comply with any legislation rule by any state or country in which we do business. We will continue to do that as we always do.

MR. PRESTEMON: Thank you, I have no further questions.

JUDGE EPSTEIN: Mr. Prestemon, I am concerned that you asked a question that didn't bring a direct response and I don't want to misstate anything that was said here. So let me just see if I can reconstruct this.

Did you ask the panel what recourse there would be if Iberdrola did not carry through on the commitment to support and encourage investments by Renewables? Was that your question?

MR. PRESTEMON: Yes, I did ask that.

JUDGE EPSTEIN: Panel, I think your answer was that that scenario was not realistic, that the commitment was firm, or something of that nature? Was that your answer?

Q. (Azagra) I remember two different things. One is whether we envisage the development of this wind investment not happening because of any issues with Iberdrola Renewables, and we do not envisage that scenario, which is also different from who is taking the guarantee of this commitment, which is the parent company, Iberdrola. So I think the last recourse is Iberdrola taking the commitment, the highest or most important one you can get from our group.

JUDGE EPSTEIN: Looking at the acceptance, the Exhibit 50, it's very carefully written. It seems to put all the necessary qualifications in there. Says that if the conditions of the wind generation industry in New York change or all the necessary permits are granted and so on.

So it's written as if some kind of enforceable agreement, but is it an enforceable agreement? Or is it simply that Iberdrola is saying now: This is our commitment and one has to accept that at face value?

A. (Azagra) If the current drivers of the economics of these projects that we have right now were to remain here within the next three years, we could comply with this.

JUDGE EPSTEIN: Right. But it's written in such a way that it seems to be setting a framework for debate down the road as to whether Iberdrola actually complied with this letter or not.

And where would that debate occur? Would you expect to come back to the Commission to have to explain if Iberdrola had not been supporting the development of wind generation?

A. (Azagra) I am not familiar with the ways in which you need later after approval of a deal, basically to come back and show how you have complied with that. Our intention is very clear here: Let tax credits remain there. I think, with economics being there, we will make sure this amount is invested in wind development in New York in the next three years. Simply of that. We will come back with approval that these are the projects in which we have invested.

MR. SCHWARTZ: Your Honor, if part of the question goes to legal enforceability of this document --

JUDGE EPSTEIN: Maybe it does.

MR. SCHWARTZ -- maybe that's not a question for a panel. On behalf of the Joint Petitioners, I would be happy to discuss it. I know that's not a standard way to go about this. This is intended to be a legally binding commitment that, if adopted, could be incorporated as a condition to the transaction and could be enforceable with all the Commission's powers for enforcement of conditions to merger orders. In other words, a violation would be a violation of a merger condition.

JUDGE EPSTEIN: And then what might happen?

MR. SCHWARTZ: Just like with the violation of any other merger condition, the Commission has enforcement authority to pursue any remedies that are under its enforceability.

In this instance, if Mr. Azagra is saying certain preconditions are met there is $100 million renewable investment goal, and if those conditions were met and the merging parties, the Joint Petitioners, failed to fulfill them, the Joint Petitioners' view is that the Commission would have all of its enforcement powers available to it, just as if any other merger conditions failed to be fulfilled.

MR. PRESTEMON: Could I ask then, based on the way the commitment is worded, if on the third anniversary of the order in this case a report by Iberdrola to the Commission showed that the Company had not expended $100 million on renewables, you would deem it to be in violation of a Commission order and subject to penalties under Section 25 of the Public Service Law?

MR. SCHWARTZ: To the extent that these conditions were met -- in other words, to the extent the conditions that Mr. Azagra laid out -- were met but the $100 million were failed to have been invested and to the extent that Iberdrola -- Mr. Azagra has already laid out that all it can do is exercise its upstream voting control. So when it exercises its upstream voting control and those conditions or preconditions are met and Iberdrola exercises its upstream voting control to invest in the $100 million, it will have met the conditions.

If it failed to do those things after those preconditions are met that are laid out in this section, the answer is: Yes, it would be violating a merger condition and the Joint Petitioners would be subject to enforcement authority by the Commission.

MR. PRESTEMON: Based on that, could I also make an on-the-record request that if there are any impediments to Iberdrola, the parent company, exercising its control over Iberdrola Renewables through its voting share to make these developments happen. Could you send us a description of that or a statement that they don't exist? The way you said it was, Well, maybe Iberdrola votes 80 percent and Iberdrola Renewables thumbs its nose at the parent.

MR. SCHWARTZ: This is a legal stipulation discussion, but the language of the corporate structuring document requires that we cannot say that we are -- that Iberdrola is one and the same with Iberdrola Renewables. The way you put it was the right way to put it. An upstream voting interest.

There is a 20 percent interest that is outside of the Iberdrola group. So in light of that, the answer -- I think that some of these concerns are a little misplaced, and what I think Mr. Azagra was trying to explain was that all they can do is exercise upstream interest.

On the record, Iberdrola can say that, We know of no restrictions that prevents Iberdrola from exercising all of its 80 percent interest in favor of the pursuit of this renewable commitment.

A. (Azagra) I think I wanted to make it clear about something. You need to review Iberdrola's strategic plan and, with that, the renewable targets that we have.

Many of the companies don't make any strategic plans. They don't announce anything. We have made it clear we want 1000 megawatts in the US a year in the next three years. That's roughly 1.52 billion investment a year. That's our target. If we're trying to do more business in New York and in the region, I think that makes it very clear what our intentions are, which is to focus as much as we can in specific territories. That's a target which is there. 1000 megawatts is almost 2 billion a year. Just keep that in mind.

JUDGE EPSTEIN: Okay.

MR. DUTHIE: If I could follow up on that.

BY MR. DUTHIE:

Q. Mr. Azagra, all of your wind projects are project-financed; is that correct? Most of them?

A. (Azagra) No. I would need to come back to you on that.

Q. In other words, resources to the project, not back to Iberdrola?

A. (Azagra) Not necessarily, no.

Q. Let me ask the question another way then:

The 100 million is the minimum commitment that you are making?

A. (Azagra) Correct.

Q. Would that commitment be in the form of equity?

A. (Azagra) This is a continuous investment. How it's financed is not purpose of commitment.

Q. The 100 million, if it were total project, would only yield 50 megawatts. The 100 million, if it were 80/20 debt-financed, it would yield 250 megawatts. So, if someone were looking for results and not just money, maybe the 250 might be a better place to commit to than the 50?

A. (Azagra) I never thought anybody was going to rephrase it that way. What we are taking here is what commitment we want to put on the table in renewables, at least in New York for the next three years. That's investment.

Where the money comes from, it doesn't matter. It's at least 100 million will be investing here. I think, from public interest point of view, the important thing is how much money comes into the state in investments. That's 100 million. That's what we are committing to.

Q. The 100 million could be a combination of debt and equity?

A. (Azagra) What's the difference?

Q. The difference in my mind is the leverage that one attains. $100 million as an equity investment in a project can generate a heck of lot more than just $100 million total investment.

A. (Azagra) Same way I could tell you that Iberdrola has no debt right now because we wanted to position the Company in the market with no debt. From that point of view, it's all equity. Any investment since they have no debt right now could be all equity. I don't agree with that. I could explain that that way but I don't think that's important.

Q. This is a question that goes back to the revenue requirement effects of the PBAs -- and I believe that Mr. Rude had established this with Mr. Mager -- that approximately $200 million PBA, or positive benefits adjustment -- I have to acknowledge, I believe that term was invented by John Benedict -- would produce a $50 million revenue requirement reduction. Is that approximately correct?

A. (Rude) With one clarification. The $200 million made up the way we made it, based on our proposal in attachment 1, that would produce $50 million. It's not any 200 million.

Q. These PBAs are also all associated with the Company's balance sheets; is that correct?

A. (Rude) No. Yes. But the effects aren't limited to that.

Q. The so-called PBA itself, the $200 million, is basically not a revenue requirement but rate base adjustment, to use that word?

A. (Rude) The PBAs are, if you will, write-offs or increased reserves.

Q. To the extent that there were $400 million of PBAs of a similar type, one would double the revenue requirement effect -- i.e., if it were a $400 million write-off, it would be $100 million of reduced revenue requirement?

A. (Rude) Not necessarily. Not dollar-for-dollar.

Q. Have you analyzed the Staff's position in terms of what effect it would have on NYSEG's and RG&E's revenue requirements?

A. (Rude) I believe that's in our rate adjustment panel's testimony.

Q. Do you recall approximately what the numbers look like?

A. (Rude) I don't have them right here. They were already cross-examined. Staff would probably have a better answer for you than I could give you.

Q. From a shareholder perspective, is it better for the Companies to have -- all things being equal with the equivalent revenue requirement impact -- a definite PBA adjustment or a synergy savings implementation?

A. (Rude) Is there a third alternative?

MR. FITZGERALD: I want to object.

MR. DUTHIE: You are supposed to say the PBA is better.

MR. FITZGERALD: Compound question, break it down so the witness can respond.

Q. All things being equal so that it's either a PBA adjustment or a synergy savings implication, from a shareholder perspective, which is better?

A. (Rude) Let me take a shot, Pedro, and you can correct it.

I think our answer is in the unilateral acceptance document. So if you could use that as a proxy for answering that question and primarily because, as we testified, this is not a transaction that produces synergies. So, therefore, a synergy implementation is purely funded by the shareholder.

MR. DUTHIE: Okay. That's it.

JUDGE EPSTEIN: Okay, Mr. Johnson?

BY MR. DAVID JOHNSON:

Q. Good afternoon. Mr. Prestemon just asked you whether Iberdrola would make a commitment to comply with the Commission's vertical market power policy statement. You just said the answer is yes; is that correct?

A. (Azagra) I said we'd comply with any policy or any legislation that the Commission, the State, or any country where doing business this. That's what I said.

Q. If the Commission were to approve the transaction and allow the Company -- and not require as a condition the provisions that IPPNY and Staff are seeking, which would prohibit the Company from seeking to build the generation within the service territory of NYSEG and RG&E -- how would you comply with the vertical market power policy statement on a going-forward basis? What exactly would the Company do?

MR. SCHWARTZ: Objection. Seems to ask for legal interpretation.

MR. DAVID JOHNSON: He said they would comply with whatever Commission orders and Commission policy statements.

MR. SCHWARTZ: Yes, but then when you're asking, "Would you be complying with this legal requirement," I am objecting to the follow-up because he's just making a general corporate statement as opposed to a specific legal compliance question.

You are asking a legal question, "How would you be complying with this specific event or this specific thing," and that's asking for a legal conclusion.

JUDGE EPSTEIN: Mr. Johnson, you seem to be asking -- I am not sure whether your question presumed that the transaction would be disapproved if the Commission were upholding its policy on vertical market power?

MR. DAVID JOHNSON: I think what Mr. Prestemon was getting at was a case-by-case determination on whether a particular project would violate the Commission's vertical market power policy statement, rather than having a blanket prohibition in the Commission's order, and I was just curious about how, going forward on a project-by-project basis, they would seek the Commission's blessing to develop a project which would be in compliance with the vertical market power policy statement.

JUDGE EPSTEIN: And I think that's more of a management problem than an attorney's problem.

MR. SCHWARTZ: I think the question, Your Honor, is -- and I don't mind having Mr. Azagra answer the question. I think the question is: As this discussion continues, if it looks like there is a legal interpretation of what -- if it looks like we are asking, Is the vertical market power policy statement a legal requirement now? That's legal question 1.

Legal question 2 is: If you do X, would it be in violation of it?

Then I think we are headed towards legal interpretation areas.

MR. DAVID JOHNSON: I was asking is the mechanism about how the initial determination would be made. His position now is that they can build any wind projects in the state without violating the policy. I think what Mr. Prestemon was implying was that, potentially, there would be a case-by-case determination for each project as they build it.

JUDGE EPSTEIN: I mean, for the panel, if you were faced with a Commission decision that said, We will look at every proposed project from the standpoint of vertical market power, what would you do? What would you do? Would you propose certain projects and not others or what would the Company do?

A. (Azagra) I think our intention is to do as many projects as we can in New York. We believe that's in compliance with any market power policy or any assessment of whether there is market power or not. I think, from that point of view, we will try to do as much development as we can in the wind business. There is no question about that.

In terms of how we'll develop each specific asset, I am not an expert or operational expert on the different steps you need to do in order to develop an asset and what permits are required. I will refer to the experts on that.

If there are specific requests that you need to do to the PSC or need to go to other regulatory bodies in the state, we will comply with that. Absolutely.

BY MR. DAVID JOHNSON:

Q. Would the Company consider making a commitment for seeking Commission approval for each particular project that there was in the NYSEG and RG&E service territory with respect to vertical market power?

A. (Mr. Azagra) if that is something that is not required by any policy right now, no, we'd not commit to that.

MR. DAVID JOHNSON: I would like to mark for identification IBER-0228.

JUDGE EPSTEIN: 60.

(Exhibit 60 marked for identification.)

BY MR. DAVID JOHNSON:

Q. Can you turn to page 65 of the Joint Petitioners' policy panel rebuttal testimony, please.

A. (Rude) Yes.

Q. Lines 4 through 6, the panel states that, The Commission has ordered RG&E to auction off the station after completion of the Rochester transmission project and that there are certain facts that have changed since the Commission's determination on the issue, and RG&E believes it is important for the Commission to be aware of these changes.

On page 66 of the testimony, lines 14 through 16, the panel states that, RG&E has identified a localized reliability need within the system that cannot be designed to be met by the RGP. Based on a preliminary analysis, RG&E agrees it can meet the reliability needs to the repowering of Russell station at its current site."

IBER-0228, which is Exhibit 56 -- 60, excuse me -- includes the Rochester area 1900 megawatts source study which was completed in the spring of 2006. Is this the preliminary analysis that RG&E bases its support on the need for repowering Russell?

A. (Rude) I would have to check on that to make sure this is complete or there wasn't something in addition.

Q. So, you are saying there may be other studies and analysis?

A. (Rude) We also submitted information to the ISO. I want to make certain of that.

MR. DAVID JOHNSON: I would like to mark for identification the April 27, 2007, letter from Mr. James P. Laurito to Honorable Jaclyn Brilling.

JUDGE EPSTEIN: 61.

(Exhibit 61 marked for identification.)

BY MR. DAVID JOHNSON:

Q. Mr. Laurito, are you familiar with that letter?

A. (Laurito) Yes.

Q. The letter states on page 2 that, "Redeveloping the Russell station will address an identified reliability concern of the NYISO in the most recent reliability needs assessment."

Isn't it true that the ISO's reliability needs assessment does not address RG&E's localized reliability needs within its system?

A. (Laurito) I don't think that is true, no.

Q. So you are saying the ISO's reliability needs assessment looks at localized reliability needs in determining whether a project is needed?

A. (Laurito) I would have to double check that with our technical folks because I think, as the RNA was initially released, we saw some cause for concern. And then there has been some discourse back and forth between our technical folks and the ISO subsequent to their initial release of that RNA about that localized reliability need. The facts and circumstances and our understanding of the RNA may have changed since the date of this letter, but I can't really speak to that in detail.

Q. Does the April 27 letter say anything about a localized reliability need?

A. (Laurito) I don't know.

Q. Do you want to quickly review it?

A. (Laurito) Sure.

It looks to speak to an identified reliability concern of the New York ISO in their most recent RNA. So it doesn't go into detail as to whether it's local or not.

Q. You don't know whether or not the 2006 1900 megawatts source study was provided to the New York ISO?

A. (Laurito) I don't.

Q. Is that something you could check on?

A. (Laurito) Sure.

Q. Turning to the Joint Petitioners' partial acceptance document, it states that -- on page 1, it states that, "Petitioners will competitively bid and auction Russell station and the other fossil units."

Lines 21 through 23 of the policy panel testimony states that, "Any --

MR. SCHWARTZ: What page, Dave?

MR. DAVID JOHNSON: Excuse me. That's page 65.

MR. FITZGERALD: What were the line references again?

MR. DAVID JOHNSON: 21 to 23, last three lines.

BY MR. DAVID JOHNSON:

Q. Says that, "Any auction of Russell station should not commence until the Commission has a chance to review and rule on RG&E's repowering proposal."

Given the discussion today about your intended purpose for the acceptance document, can you please confirm that this aspect of your rebuttal testimony has been supplanted by the acceptance document?

A. (Rude) It has been supplanted assuming the transaction is approved and closes. We will continue to work on this until then.

Q. Would the Petitioners commit to filing the auction protocols within one month of the Commission order approving the proposed transaction?

A. (Rude) If that was included in the Commission approval, we probably wouldn't view it as "fatal," to use a term that was used earlier.

Q. Given the alleged local reliability issues you identified in Exhibit 60, would it be unreasonable for the Commission to require the sale of the plants within nine months of the Commission's order approving the protocols?

A. (Rude) I think that could be set as a goal and probably is not an unreasonable goal, but there has to be caveats for market conditions and time for adequate review by the parties on the protocols and all those details. But in my experience, that's not an unreasonable time frame.

Q. Turn to page 67, please, of the rebuttal testimony.

I think earlier today in response to questioning you said that the sale of the fossil plants would not be a detriment to rate payers because you could structure a contract. Why couldn't you do that with the hydro plants?

A. (Rude) I am not sure we are saying that here. I think we are saying these are--renewable resources are valuable. They have never been challenged, to my knowledge, before, as being a problem for T&D ownership. These are very low-cost sources of power, and before this transaction, I was not aware that there was any opposition to T&D ownership of these assets. So, we really haven't thought about and considered a contract back.

Q. But if you sold them, they would remain renewable projects. They would still have the benefit of a renewable project. That aspect of the project wouldn't disappear if sold to a third party.

A. (Rude) If they sold higher than book value, that would mean that a development must view that the market value is greater. The only way they would get that is to charge above-utility profits. In our revenue stream, that would give them more than utility profits, so I don't see how that would benefit customers.

Q. Couldn't it be a benefit if the utility that bought them redeveloped them or enlarged them?

A. (Rude) As part of the utility portfolio of assets, we are always looking at the betterment of the facilities, particularly given that they are renewable.

Q. Isn't it true that the New York ISO has no authority or ability to direct where and how a transmission owner maintains its transmission system?

A. (Rude) I think we answered that in one of the IRs. I think that's almost a direct quote from one of your IRs. So I would answer it in the same way we answered it in the data request.

Q. The way you answered it, it is up to FERC to interpret the language in the ISO tariffs?

A. (Rude) I think we went further than that.

Q. "The New York ISO coordinates all requests for transmission outages based on the potential impact on system reliability."

MR. FITZGERALD: Could you identify the IR you are referring to.

MR. DAVID JOHNSON: IBER-0083.

A. (Rude) I accept that answer.

BY MR. DAVID JOHNSON:

Q. Has the New York ISO ever asked RG&E or NYSEG to perform maintenance on its transmission lines?

A. (Laurito) I don't know the answer to that question. It's a 150-year-old company.

Q. The ISO's only been around since 1998.

A. (Rude) We are not aware of that.

Q. Turning to Exhibit 57, which is IBER-0008-S.

Can you tell us about these five additional projects which were identified on March 14? Are these projects that

Iberdrola has acquired from another company?

MR. SCHWARTZ: Your Honor and Dave, could we just wait to make sure the witnesses pull this data request in front of them.

MR. AZAGRA: Would you like to repeat your question.

BY MR. DAVID JOHNSON:

Q. The five projects which were identified for the first time in this information response, beginning with the 46 megawatt Sangerfield projects, were those projects acquired from another developer by Iberdrola?

A. (Azagra) I don't know the answer. We could come back to you if you need. We could get that answer to you.

Q. Earlier this afternoon, you were talking about projects that are in the pipeline and projects that are planned. How long have these projects been in the pipeline, as you described earlier today?

A. (Azagra) If these names are not here, it's because they have joined the pipeline. Not every potential project basically is raised by the development people into the pipeline until they reach a minimum set of criteria. These projects could have been there with an option perhaps but not with the substance of putting in what we call pipeline. So the reason they are here right now is because, for whatever reason, they comply with two out of the 30 items they need to comply with, six out of the 40 criteria they have to comply with.

Once they comply with six, become pipeline. Low probability would be at the very end of the pipeline but not what we call pipeline. That's the reason we are here. Otherwise, they not known by any management at all within the firm.

Q. The projects which were identified in No. 1, those projects have been in the pipeline, and at the time those projects were identified, the five new projects were not in the pipeline?

A. (Azagra) In what we define as pipeline? Yes, that's correct.

Q. How long has the Company known about these new five projects? Was it March 14 that it first identified these projects?

A. (Azagra) I don't know. We check regularly with them. When we became aware of the projects, we made them public to you.

Q. Are there any other projects which Iberdrola has in any phase of the planning process that haven't been disclosed on this list?

A. (Azagra) If they were part of the pipeline, they would be here. I think many other companies call pipeline what we don't call pipeline.

I would encourage you to review our IPO materials where you will see what we define as pipeline as compared to many other companies that they call pipeline things that would never be real. I think the delivery ratio that we have or the track record of bring megawatts into operation prove that not every megawatt that people say is a real megawatt. We call pipeline according to specific criteria. Otherwise, we don't believe those are even potential projects.

MR. DAVID JOHNSON: That's all the questions I have.

MR. FOGEL: Your Honor, I had not planned on asking any questions. I just had some clarification questions on the partial acceptance document filed on Friday.

BY MR. FOGEL:

Q. Good afternoon, panel.

I'd like to direct your attention to the first page of Exhibit 50, which is the partial acceptance document. When you have it give me a signal.

Dealing with the vertical market power, you indicate that you would make the commitment to competitive bid in auction the Russell Station, the Allegheny Station, Peaker Station 3 and Peaker Station 9; is that correct?

A. (Rude) Yes.

Q. I believe in response to a piercing question from Mr. Mager, you had indicated that basically these were older facilities paid for by ratepayers, correct?

A. (Rude) I don't recall the piercing nature of the question, but I believe I answered yes to that.

Q. Would you also agree that the potential exists that if there is an auction as a result of that, or maybe a subsequent step, there may be some sort of buy back purchase power agreement between you and whoever purchases the facility?

A. (Rude) That's a possibility. It wouldn't be for Russell because it's a closed plant.

Q. For other ones, that could happen?

A. (Rude) It's possible. It seems very unlikely given their size.

Q. In the event that would happen, would the Company be willing to give a commitment that the manner in which that power was reflected in rates would be done in such a manner that would be competitively neutral -- strike that.

Would you agree that, in the event of a purchase power arrangement, that the manner in which the cost of the power was reflected in utility rates would be accomplished so that it was competitively neutral vis-a-vis customers taking commodity supply from the Company and those taken from independent supplier?

A. (Rude) I believe that's the way we operate today. I wouldn't believe it would be any different in the future.

MR. FOGEL: Thank you.

JUDGE EPSTEIN: I have maybe a couple of questions in two areas.

First of all, as far as the Russell Station is concerned, I don't have a good general understanding of what the status of that facility is, and maybe it's in the testimony somewhere and I missed it. But it's my understanding that Energy East, last month, entered into a settlement of some litigation that was brought by the State of New York -- I assume the Attorney General -- and that the settlement involved a commitment to shut down the plant. And it involved certain commitments in the event of construction of a new facility. That if an application were filed, I assume, for a permit to build a new facility, that proposal would involve state-of-the-art gas combustion.

I don't know whether that's the same thing as repowering. That's part of my problem. Part of the problem is I have Exhibit 50, the acceptance document, where the Joint Petitioners would undertake to auction the facility, and I don't understand whether that's independent of any possible plans to apply for a permit to build a new state-of-the-art facility. In other words, when you commit to auction the facility, does that refer only to the existing Russell Station that's due to be shut down under this settlement?

And I think that's the extent of my question.

A. (Rude) As I responded previously, if this condition were accepted and the Commission approved the transaction, the Company would abandon its repowering efforts.

JUDGE EPSTEIN: The repowering, that's the state-of-the-art gas combustion, that's the subject of the settlement of the litigation?

A. (Rude) I don't have the settlement in front of me, but the way I interpret the settlement is: If RG&E repowers Russell, then it must be a natural gas combined cycle. I don't necessarily -- although it would be a legal interpretation, which my colleagues from time to time say I try to make -- but I would think that if there was a new owner of that site, it's not necessarily restricted to them on what they do with that site. But if RG&E were to repower, then it must use natural gas.

JUDGE EPSTEIN: Okay, so, there was a question and answer before about the fact that the Petitioners were withdrawing -- or they were, let's say, discarding that part of their rebuttal testimony that said that any further Commission action on the Russell Station should await the disposition of the RTP. That's all gone by the board now, assuming if the transaction were approved?

A. (Rude) There is really two steps. The RTP must be completed before Russell can be fully shut down. That's anticipated to happen in about six weeks. So that's the first step.

Our efforts to develop a plan to repower and a filing with the Commission that we said we would make in June of this year, we would abandon those efforts. They would be supplanted by this partial acceptance if it was included in a condition approving this merger.

JUDGE EPSTEIN: And my other area of questions -- this is because it's something that was raised rather often by people that made statements or talked to me while I was touring the service territory on public statement hearings -- and that is about employee benefits and particularly pensions and medical benefits.

So just as a matter of -- first of all, just as a matter of literal interpretation, on page 27 of the rebuttal at line 9, it says, "Iberdrola has committed that existing employee compensation and benefits..."

First of all, that doesn't mean -- that is not limited to compensation and benefits for existing employees but rather it means existing compensation and benefits and pensions and other post-employment benefits; is that what that sentence means?

A. (Rude) I believe that's a correct interpretation of the merger agreement, yes.

JUDGE EPSTEIN: And then, all the types of benefits I just referred to -- namely pensions and -- let me back up.

OPEBs includes medical benefits?

A. (Rude) Medical benefits, yes.

JUDGE EPSTEIN: So that pensions and medical benefits are subject to that 18-month limitation?

A. (Rude) Yes. I don't know if I would use the word "subject to." I would say "included in."

JUDGE EPSTEIN: Is it possible for you to expand on that statement by differentiating between pensions and medical benefits? Would you say, for example, Well, one of those things is probably going to last a lot longer than the other, or something like that.

Can you make a more refined statement about that or is that pretty much the extent of how you would describe Iberdrola's commitment?

A. (Azagra) I think probably my answer would go to the past practice, how we run with these matters within the group. I think any major change in how those matters that you are raising is addressed or is dealt with in the future, it's always done on an agreement basis with workers' representatives. So I think that's how we approach things.

We did major changes in pension systems in Iberdrola, I think, in 1996. That was done through agreement with all the unions and all the workers' representatives. There was no problem with that. It was agreed so from that point of view. I think the reason why we say things like "substantially" is, because of a merger taking place, we cannot maintain certain ways of people being paid. Perhaps we do it in different way and prefer other ways. The items you are raising, pensions and health systems, I think we would never take any decision without agreement with trade unions and other workers' representatives. That's the approach we follow everywhere.

JUDGE EPSTEIN: Earlier, when we were talking about I think it was employee levels and whether they would be increased, decreased, or stable, I understood you to be putting forth kind of two competing descriptions of Iberdrola's track record.

One was that, if I understood it correctly, that Iberdrola really defers to the management of the subsidiaries, such as Energy East, on questions about how the operation can best be managed, questions that might have an impact on employees.

And on the other hand, Iberdrola itself has a track record of working smoothly with labor representatives.

So I am a little unclear about whether a question such as the medical benefits or the pensions, whether that would be more an Iberdrola judgment or an Energy East judgment.

A. (Azagra) It will be a local management issue to be addressed because they are the ones who know the details of these matters at the operating companies. However, there were old policies in the firm on labor matters. No issues. No problems. No strikes. No conflicts. That's something we will make sure -- I don't know the track record of Energy East, but that will be taken into account also going forward. I think the basics of the overall culture, how to address certain issues, will extend to the new companies joining the group.

JUDGE EPSTEIN: Thank you. Other cross for this panel? Redirect?

MR. SCHWARTZ: Your Honor, could we have a few minutes with the witnesses? Is it appropriate to take a little break and come back?

JUDGE EPSTEIN: I was planning on a 15-minute break at 4:00.

MR. SCHWARTZ: That would be preferable to us.

(Recess taken.)

MR. BREW: Your Honor, we are presenting testimony of Frank R. Radigan.

FRANK R. RADIGAN, after first having been duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. BREW:

Q. Mr. Radigan, please state your full name and address.

A. Name is Frank Radigan, 120 Washington Avenue, Albany, New

York 12201.
Q. Mr. Radigan, did you prepare direct testimony in this case?
A. I did.
Q. Do you have before you a typewritten document consisting of a cover page and 11 pages of questions and answers entitled direct testimony of Frank R. Radigan on behalf of Nucor Steel Auburn?
A. I do.
Q. Was that the testimony you prepared for this docket?
A. It was.
Q. Do you have any corrections to make to that testimony?
A. I do not.
Q. If I were to ask you the questions contained therein would your answers be the same today?
A. It would.
MR. BREW: I ask the direct testimony of Mr. Radigan be copied into the record.
JUDGE EPSTEIN: Good.
(The following is the prefiled testimony of Frank Radigan:)

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?

A. My name is Frank W. Radigan. I am a principal in the Hudson River Energy Group, a consulting firm providing services regarding the electric utility industry and specializing in the fields of rates, planning and utility economics. My office address is 120 Washington Avenue, Albany, New York 12210.

Q. WOULD YOU PLEASE SUMMARIZE YOUR EDUCATION AND BUSINESS EXPERIENCE?

A. I received a Bachelor of Science degree in Chemical Engineering from Clarkson College of Technology in Potsdam, New York (now Clarkson University) in 1981. I received a Certificate in Regulatory Economics from the State University of New York at Albany in 1990. From 1981 through February 1997, I served on the Staff of the New York State Department of Public Service ("DPS") in the Rates and System Planning sections of the Power Division. My responsibilities included resource planning and the analysis of rates, depreciation rates and tariffs of electric, gas, water and steam utilities in the State and encompassed rate design and performing embedded and marginal cost of service studies as well as depreciation studies.

Before leaving the DPS, I was responsible for directing all engineering staff during major rate proceedings including those relating to integrated resource planning and environmental impact studies. In February 1997, I left the DPS and joined a firm called Louis Berger & Associates as a Senior Energy Consultant. In December 1998, I formed my own Company. In my 27 years of experience, I have testified as an expert witness in utility rate proceedings on more than 60 occasions before various utility regulatory bodies, including this Commission, the Nevada Public Utility Commission, the New York State Department of Taxation and Finance, the Connecticut Department of Utility Control, the Rhode Island Public Utilities Commission, the Michigan Public Service Commission and the Federal Energy Regulatory Commission.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. I am submitting this testimony on behalf of Nucor Steel Auburn, Inc. ("Nucor"), which operates an electric arc furnace-based steel manufacturing facility located in Auburn, New York. Nucor employs approximately 300 people at this steel "mini-mill" facility, where scrap steel is recycled and molten steel is recast into a variety of steel products, such as rebar, that are then sold in the highly competitive steel commodity markets. Nucor recycles approximately 500,000 tons of steel scrap annually and is the largest single point electric load on the New York State Electric & Gas Corporation ("NYSEG") system. Since acquiring this operation from Auburn Steel in 2001, Nucor has invested over $30 million in modernizing the facility. As an energy intensive manufacturing facility, reliable and cost-competitive electric service is critical to Nucor's operation.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I will address the need for the Commission to establish specific commitments from the petitioners regarding economic development initiatives and support for local communities.

Q. WHAT IS THE PETITIONERS' PROPOSAL WITH RESPECT TO ECONOMIC DEVELOPMENT AND LOCAL COMMUNITY SUPPORT?

A. The petitioners claim that the synergy benefits typically associated with utility mergers will not be achieved with the Iberdrola acquisition of the Energy East companies, but that New York consumers nonetheless will benefit from NYSEG and RG&E becoming a part of Iberdrola. (Petition at p. 2). The petition asserts that these benefits will be found in the following areas:

- Iberdrola's global energy experience;
- Iberdrola's focus on energy efficiency, clean technologies and the environment;
- Financial stability;
- Commitment to customer service and reliability; and
- Commitment to local communities

(Petition at p. 3). With regard to the last of these items, the petition maintains that "Iberdrola will not seek any reduction in the level of any existing economic development initiatives in New York in connection with the Proposed Transaction [merger]." *Id.* The petitioners subsequently restate that commitment without elaboration. *Petition at p. 15; Benefits and Public Interest Panel at p. 27.* Essentially, Iberdrola maintains that its acquisition of Energy East will produce no adverse impacts for New York ratepayers, but it does not offer any tangible consumer benefits.

Q. IS THE PETITIONERS' ASSURANCE OF NO ADVERSE RATEPAYER IMPACTS SUFFICIENT TO APPROVE THE ACQUISITION?

A. No. The Commission should require specific commitments that provide tangible benefits to New York consumers.

Q. PLEASE EXPLAIN.

A. I share the concerns expressed by the Maine PUC advisory staff in its review of the proposed merger that the acquisition of Energy East by a large, multi-national entity, such as Iberdrola, creates new risks and concerns for consumers that must be considered and addressed. In a November 6, 2007 bench memo, the Maine PUC Advisory Staff wrote:

> CMP's executive management resides in Maine. Energy East's headquarters are in Maine. In contrast, Iberdrola's executive management and headquarters are in Spain. Although the Petitioners and Iberdrola have indicated that the Energy East and CMP executive and management structures will not be changed if the acquisition is approved, this is not guaranteed in perpetuity, or, for that matter, at all.
>
> More importantly, even if Energy East's and CMP's executive and management structures never change, it is likely that ultimate decision-making authority will reside with officials at Iberdrola's headquarters in Spain.
>
> Iberdrola's physical and language separation from Maine creates the potential that decisions affecting CMP may be removed from the local concerns of Maine's citizenry and government. Iberdrola' management is unlikely to be as familiar with Maine-specific issues and concerns, yet they may be the ultimate decision-makers about CMP's investments and operations, as well as its positions and actions with respect to regional and policy issues of importance to Maine.
>
> This is not a theoretical concern. Maine has experience with other utility acquisitions, and has observed the tendencies of large companies to treat as unimportant problems of an affiliate located in a relatively small and remote state. In particular, we note Maine's less than positive experiences in telephone and natural gas, where Maine utilities have been acquired by large, distant holding companies, followed by degradation of service quality and diminished sensitivity and responsiveness to Maine regulatory concerns and issues.
>
> We do not mean to suggest that this acquisition would lead to a similar result. However, it is clearly a risk.[1]

---

[1] [Footnote omitted].

I believe that the Maine PUC advisory staff accurately noted that ultimate decision-making in many, or most, aspects of Iberdrola's U.S. utility operations and investments will be made in Spain.

With respect to New York utility operations, there is a risk that Iberdrola will not share New York State and Commission concerns with regard to economic development initiatives and infrastructure investment, among other matters, when it comes to the conglomerate's actually investing in the NYSEG and RG&E service territories. These are, however, vital concerns for reining in New York's high cost of living and doing business in New York, as the Governor emphasized in his January 9, 2008 State of the State address. The appropriate remedy to address this risk is for the Commission to establish specific commitment requirements as part of any merger approval order. I expect that the DPS Trial Staff and other parties will address the need for positive consumer benefits in a number of areas. I confine this testimony to the need for specific commitments regarding economic development initiatives.

Q. PLEASE DISCUSS THE IMPORTANCE OF MANUFACTURING JOB RETENTION AND ATTRACTION.

A. Support for manufacturing is essential for Upstate economic development efforts to be successful. Manufacturing industries contribute more to any local, regional or national economy than any other sector. The Manufactures Association of Central New York ("MACNY") reports that manufacturing employs over 550,000 New Yorkers and contributes $61 billion annually to New York State's GDP. Compared to other sectors of the economy, manufacturers pay higher wages, generate better benefits, and stimulate more high technology growth through research and development and productivity improvements.

MACNY reports that manufacturing jobs pay on average 20 percent more than other sectors of the economy. In fact, MACNY also reports that manufacturing jobs pay salaries on average of over $48,000 a year. Service sector employees earn about 60 percent of that, and retail workers earn about 40 percent of the wages paid to manufacturers. Manufacturing accounts for over 70 percent of private sector research and development in the United States. Every manufacturing job creates more than 2.5 related jobs in other sectors, and every dollar spent generates an additional $1.37 in economic activity. Simply put, manufacturing is the wealth generating sector of the New York economy.

It is no secret that Upstate New York, and particularly the areas served by NYSEG and RG&E, has been losing the battle to retain and attract quality jobs. The US Bureau of Labor Statistics reports that between March 1990 and March 2007 manufacturing jobs in New York have dropped 55%. On January 5, 2008, the Albany Times Union reported that manufacturing jobs in New York dropped almost 29% between 1996 and 2006, a bigger decline than all states except North Carolina and Rhode Island. In the same article, the Times Union also reported that the cost of doing business in New York is second only to the cost of doing business in Hawaii, and is 30.7% above the national average.

Q. **PLEASE CONTINUE.**

A. The cost of electricity is a very large part of this cost disparity. The Albany Times Union reports that the average price of electricity for 2007 in New York State was

14.54 cents per kWh, the fourth highest in the nation and 66 percent above the national average of 8.77 cents. An October 2007 report prepared by Power in the Public Interest ("PPI") suggested that New York's retail deregulation policies are responsible for some of this disparity. (*See* Exh. FWR-1). PPI reported that retail electricity prices in deregulated states averaged 2.0 cents per kWh higher than rates in traditionally regulated states in 2000, and that, by 2007, this rate disparity had grown to more than 4.0 cents per kwh.

PPI also reported that in 2000, the average electric rate for all customers in New York was 10.6 cents/kwh, while the comparable figure for the collective regulated states was 6.0 cents/kwh—or a difference of 4.6 cents. According to PPI, as of June 2007, the difference had widened to 6.8 cents (14.5 cents/kwh for New York and 7.7 cents/kwh for the regulated states). For the 12 months ending June 2007, New Yorkers paid $22 billion for their electricity. The same amount of electricity at the regulated states' average rate would have cost $11.6 billion—a difference (or comparative purchasing-power disadvantage to New Yorkers) of $10.4 billion for a 12-month period.

I recognize that there is considerable controversy regarding the claimed success or failure of competitive retail power markets. There is little doubt, however, that on the ultimate question of cost competitiveness New York has continued to lose ground on the electric rates charged to homes and businesses.

Q. WHAT PROGRAMS EXIST IN NEW YORK TO REDUCE ELECTRICITY COSTS FOR NEW YORK MANUFACTURING LOADS?

A. Historically, the State has administered a series of economic development programs that streamed low cost hydro power and excess nuclear capacity through the New York Power Authority ("NYPA"), and the Commission also approved and provided oversight to a variety of utility administered economic development initiatives. NYSEG and RG&E historically offered bundled, and more recently, unbundled, job retention and attraction ("flex rate") service agreements. NYSEG also has a specific budget for various consolidated economic development programs that was established in its last delivery rate case.[2]

Q. ARE THESE EFFORTS WORKING?

A. The historic NYPA, bundled flex rate and Economic Development Zone Incentive ("EDZI") discounted rate programs have been highly successful, as indicated by the number of manufacturing loads that continue to take service under one or more of these programs. The same cannot be said of the current programs, which offer limited benefits or availability, as is evidenced by the continued erosion of manufacturing jobs noted above.

Q. PLEASE DISCUSS THE PETITIONERS' PROPOSAL REGARDING ECONOMIC DEVELOPMENT INITIATIVES.

A. The petitioners correctly listed a commitment to local communities and economic development initiatives as an important component of the acquisition assurances to the State. The vague representation in the petition that Iberdrola will not further

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[2] Case No. 05-E-1222, Order Adopting Recommended Decision with Modifications, dated August 23, 2006; Order on Rehearing, dated December 15, 2006.

degrade current programs that are ineffectual, however, is not a satisfactory response to one of New York's most compelling challenges.

In the recently completed merger of KeySpan and National Grid, the Commission determined that utility merger terms must be shown to be in the public interest within the borders of New York, both in the short- and long-term. The Commission further noted that the burden of proof with respect to all the merger and revenue requirement issues rests with the petitioners. In Nucor's view, to satisfy the Public Service law requirement the petitioners must demonstrate that there will be positive and tangible benefits to New York consumers.

Q. PLEASE DISCUSS THE NEED FOR COMMITMENTS REGARDING ENHANCED ECONOMIC DEVELOPMENT INITIATIVES.

A. It is well established that uncompetitively high energy costs are a leading barrier to the retention of quality manufacturing jobs in the Upstate areas served by NYSEG and RG&E. On January 9, 2008, Governor Spitzer's State of the State address discussed the urgent need to take the initiative to stem the tide of Upstate job losses. The Governor quoted Franklin Delano Roosevelt's comment that "It is common sense to take a method and try it; if it fails, admit it frankly and try another. But above all, try something." This observation clearly applies to the need for more innovative approaches to stemming the impact of high energy costs on Upstate manufacturing. Effective utility rate economic development initiatives are a key feature of successful job retention and attraction efforts, and revitalizing those initiatives should be a Commission focus in this docket. The "no adverse impact" approach proposed by the Petitioners in this docket is altogether inadequate.

Q. WHAT DOES NUCOR RECOMMEND?

A. Much more needs to be done to establish competitive power rates for manufacturing businesses that are investing in facilities and will retain or create quality jobs in New York. The delivery portion of a utility bill is a relatively small component of the total bill, and economic development discounts to the delivery component alone cannot be expected to be effective. Nucor recommends that the Commission require Iberdrola to expand the range of economic development program options and that it encourage the utility to develop innovative approaches. This could include exempting flex rate and other qualified manufacturing loads from various surcharges (SBC, RPS, EPS, etc.) or streaming lower cost sources of supply or hedged positions to those qualifying loads. For example, NYSEG has hydroelectric units and the cost of power from certain remaining contracts with Independent Power Producers that are forecast to be well under market prices. Streaming low cost power sources to retain and attract manufacturing jobs is not a new concept in New York. It has been done in Jamestown, NY (Case 02-E-1335) and Massena, NY (Alcoa) to stream low cost hydro power to customers in order to retain or attract jobs. In any event, in view of current uncompetitively high energy costs and the State imperative to revitalize the Upstate economy, the Commission should require Iberdrola to develop and file an aggressive and innovative job retention and attraction program.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes it does.

BY MR. BREW:

Q. Secondly, Mr. Radigan, did you prepare an exhibit to your testimony?

A. I did.

Q. Do you have in front of you an exhibit labeled FWR-1, which is an article dated October 9, 2007 entitled Electricity trends in New York compared to trends in price regulated states?

A. Yes.

Q. Do you wish to sponsor that article as an exhibit?

A. I do.

MR. BREW: I ask the item be marked for identification. I believe the number is 61.

JUDGE EPSTEIN: 62.

(Exhibit 62 marked for identification.)

MR. BREW: Mr. Radigan is available for cross-examination. I understand none of the parties have questions for him.

JUDGE EPSTEIN: You are excused. Thank you very much.

(Witness excused.)

(Recess taken.)

JUDGE EPSTEIN: We are back on the record with the redirect of the panel.

REDIRECT EXAMINATION

BY MR. FITZGERALD:

Q. Good afternoon, panel. Do you recall an Exhibit 54 from Staff? It was entitled, on the very top, "Pending Merger Premium." First sentence was, "How much of the premium should be assigned to the PMP?"

A. (Rude) Yes. Yes, I believe it came from the Maine bench analysis in the ARP proceeding.

MR. FITZGERALD: Excuse me, Your Honor. Staff counsel doesn't seem to be here at the moment.

(Off the record.)

JUDGE EPSTEIN: Mr. Fitzpatrick, if you would start over with that question you were asking.

MR. FITZGERALD: Sure, Your Honor. Be happy to.

Q. Mr. Rude, do you recall an Exhibit 54 from Staff that they presented earlier today?

A. (Rude) Yes, I do.

Q. Could you turn to page 3 of that exhibit. On page --

A. (Rude) Yes. It's the first page.

Q. -- on page 3 it references a data response IBER 0157 as a source of certain data. Is that response important to understand the identified allocation of premium set forth later on the page?

A. (Rude) Yes, I think it would be very important for that data response to be attached as part of this exhibit as, I believe, Staff counsel offered to make sure it was complete. I think that's very important that was the case.

MR. FITZGERALD: Your Honor, we'd like to take Staff counsel up on its offer earlier today and request that the full document be marked as Exhibit 54 from which there's excerpted certain pages. And also we'd like to reserve the exhibit number for the IBER 0157 response, which is referenced therein.

JUDGE EPSTEIN: Is one of these the same exhibit that's where Staff counsel was saying, You'd better have some consultation because you are dealing with hundreds and hundreds of pages?

MR. FITZGERALD: I don't believe so, Your Honor.

JUDGE EPSTEIN: So, we will reserve number 63.

(Exhibit 63 marked for identification.)

MR. VAN RYN: And what is 63 being reserved for?

MR. FITZGERALD: For IBER 0157, the data responses referenced in the exhibit, and also where we've made the request to have the full document included as part of Exhibit 54 from which it was currently exempted.

MR. VAN RYN: We will look into it.

MR. FITZGERALD: Your Honor, is that a statement by Staff counsel that he will include it in the record?

MR. VAN RYN: I think the judge was saying it might be hundreds of pages long. I need to look at the whole thing, so --

JUDGE EPSTEIN: All right. Well --

MR. VAN RYN: You are asking me about a document I don't have in front of me. So I have to look at it, see exactly how it...

MR. FITZGERALD: Your Honor, one other thing, too. It would be much more efficient if we have the full document in the exhibit in case we need to refer to other sections of it to put it in context. Our witness has already indicated that it would be very important to have the full context for this document.

JUDGE EPSTEIN: Okay. Well, would it be --

MR. VAN RYN: The alternative here is that he seems to have more familiarity with the whole document than I do. This is, I believe, in an Energy East proceeding in Maine. Might be better if -- petitioners might have easier access to it than I do.

A. (Rude) If I could make a suggestion, what I had proposed is that just IBER 0157 could be attached to these two pages or that just the appendix, not the entire bench analysis with IBER 0157.

MR. VAN RYN: You are offering to put in the whole information request and you have access to it?

A. (Rude) Yes.

MR. VAN RYN: All right. That would be fine.

MR. SCHWARTZ: Your Honor, I have a few redirect questions, as well.

JUDGE EPSTEIN: That goes to Exhibit 63, the IBER 0157, but what about the other question regarding 54 -- revising Exhibit 54 to include more than what we have in there now?

MR. FITZGERALD: Your Honor, Staff took an excerpt from it under the presumption they would have the full document and be provided a copy of that exhibit in its entirety.

JUDGE EPSTEIN: And --

MR. FITZGERALD: If they can not, Your Honor, we certainly can provide it ourselves for inclusion in that exhibit.

JUDGE EPSTEIN: Now, is that something we have to examine --

MR. VAN RYN: Yeah, I would think so. We are talking about an attachment to a Maine bench decision --

JUDGE EPSTEIN: Yeah, well --

MR. VAN RYN: -- which is very lengthy, but if they want to provide the whole bench decision for the record, that's fine with me.

JUDGE EPSTEIN: I also don't want to put in a lot of extraneous material if we are talking about a lot.

MR. VAN RYN: It's a bench decision so sort of a like a recommended decision, hundreds of pages.

JUDGE EPSTEIN: I guess what I am not understanding is whether this has to be resolved while the witnesses are here --

MR. VAN RYN: That's fine, Your Honor.

JUDGE EPSTEIN: -- because if it doesn't maybe we should take this off line and resolve it sometime in the next day or two.

MR. FITZGERALD: That's fine, Your Honor. What we will do is we will provide the IBER 0157 the new exhibit numbers you just identified.

And I will work with Mr. Van Ryn regarding any additional pages that are necessary for Exhibit 54 with the idea of keeping them as limited as possible.

JUDGE EPSTEIN: Okay.

MR. SCHWARTZ: Your Honor, I have a few redirect questions, as well.

BY MR. SCHWARTZ:

Q. Panel, Mr. Mager asked a number of questions about goodwill tax amortization. And I think Mr. Azagra answered those questions from Mr. Mager.

What is the financial goodwill attributable to?

A. (Azagra) The financial goodwill is -- it has not been determined and cannot be determined before closing the transaction until it has been reviewed by the auditor. He basically comes up with the valuation of the goodwill and it's allocation to financial goodwill, intangible or potential update on value of the assets, as we have explained in the rebuttal and some of the questions and answers.

I think it's important that that financial goodwill is a portion which basically we have committed that it would not be sent into rates or anything like that. So from that point of view whether there are any potential tax treatment back in Spain, I think, you know, we are making sure that the rate payers in New York, they have no impact with financial goodwill.

Q. Mr. Azagra, who pays for the costs of that financial goodwill?

A. (Azagra) The taxpayers will not pay for that. It's our shareholders, the ones, you know, that they are paying for that. We have committed basically to keep it at the parent Company.

Q. Thank you.

Mr. Mager also asked the panel whether there would be any commitments for higher or more stringent reliability standards, service quality standards and gas safety standards. I think Mr. Rude answered those questions.

Mr. Rude, do you have an opinion about whether any such higher standards would be necessary or required as part of this transaction?

A. (Rude) Yes, I have an opinion. No, I think the current standards are operating fine for all of these companies and all the companies have had a very good record.

However, as we testified, we are hoping over time that the sharing of best practices will allow us to further improve the delivery of service. We're always looking for ways to do that. And, again, we're hopeful of joining forces with this large global utility, that that will be possible.

Q. Thank you.

There were a few questions asked, I believe also by Mr. Mager, about Standard & Poor's rating and the difference between the Iberdrola rating and Energy East rating. And I believe Mr. Azagra answered those questions.

Mr. Azagra, have you examined the comparison of ratings from other rating agencies other than Standard & Poor's?

A. (Azagra) Standard & Poor's, there is one notch difference between Iberdrola and Energy East's rate rating. Moody's has two notches. You know, we are an A3 versus BAA2 for Energy East.

And if you look into Fitch IBCA, that's another major rating agency. There is a two-notch difference between the two companies, Iberdrola being an A-rated company and Energy East being triple B-rated company.

Q. Mr. Azagra, just to clarify, how many notches is that on Fitch?

A. (Azagra) Two notches -- sorry, three notches. Sorry about that.

Q. Thank you.

Panel, you were asked a few questions about the Gamesa issues and Gamesa projects in New York.

Mr. Azagra, you answered those questions, I believe, raised by Mr. Mager. How did you obtain information about Gamesa projects in New York?

A. (Azagra) That was asked by Mr. Van Ryn and I've been informed that's a publicly available information.

Q. Thank you.

There were a few questions Mr. Mager asked about PTCs. And the questions went to the utilization of those production tax credits.

Mr. Azagra, you addressed those questions from Mr. Mager. Right now prior to the acquisition do you have a view as to whether Iberdrola Renewables projects currently utilized production tax credits?

A. (Azagra) As has been explained in the Iberdrola Renewables IPO, Iberdrola Renewables has been using, uses, and we estimate that we continue to use equity investors. That's a very liquid market right now in the US. And they have not been able to achieve right now 100 percent of the tax equity investment needed in all of the projects.

And that's the estimate going forward we have without the need of the transaction or any other transaction by Iberdrola.

Q. Thank you.

We heard some -- quite a bit of discussion including questions from Mr. Prestemon about the $100 million renewable commitment in the partial acceptance document.

And with that back and forth, Mr. Azagra, there may have been some ambiguity about committed levels of renewable development and goals or targets for renewable development. Would you like to elaborate and clarify any misunderstanding on that?

A. (Azagra) As stated in our strategy plan and stated in the Iberdrola Renewables strategy plan, when the IPO took place the intention in the US market is to develop and start operation of 1,000 megawatts a year for the next three years. That is roughly 1.5 to over $2 billion investment per year.

Within that context what we are doing here is committing to at least 100 million in New York State for wind development, but it's important to highlight our much more ambitious and compromised investment in the US.

MR. SCHWARTZ: Thank you. I have no further redirect.

JUDGE EPSTEIN: Recross.

MR. VAN RYN: Yes, Your Honor.

RECROSS EXAMINATION

BY MR. VAN RYN:

Q. On the Gamesa projects we discussed your role in -- I believe it was with Bank BBVA and investing in Gamesa.

Do you remember that?

A. (Azagra) If you can elaborate a little bit more. What exactly --

Q. You and this bank formed a holding company and that holding company invested in Gamesa; is that correct?

A. (Azagra) Correct, IBV.

Q. When you were performing those investments you used only publicly available information in deciding whether -- in monitoring Gamesa and deciding whether to invest in Gamesa?

MR. SCHWARTZ: Objection, Your Honor. This goes beyond the scope of redirect.

MR. VAN RYN: Your Honor, I believe he asked and the witness said he relied only on publicly available information.

MR. SCHWARTZ: That's not true, Your Honor. The witness said that with respect to the Gamesa projects in the United States that he identified and were asked about that, that information was obtained from publicly available data, not the subject matter Mr. Van Ryn has requested.

MR. VAN RYN: Then we'll move on to the Gamesa project.

Q. When you investigated the purchase of the Gamesa projects in states other than New York, you relied only on publicly available information in performing your investigation?

A. (Azagra) Those are two different matters. One is agreements that we may reach with Gamesa or other developers in which we agree we will buy some assets from those companies when those assets become in operation.

So basically that's a negotiated agreement between Iberdrola Renewables and Gamesa and are here in this case or any other Company. That's a bilateral negotiation by which the two companies reach an agreement in order to have a share purchase agreement of assets or a company or whatever -- they reach an agreement with.

That's, I think, different from the other public available information of two of specific periods that are happening. That's why in those negotiations, you know, that agreement they will share information as needed in order to reach that agreement.

MR. VAN RYN: Thank you for the clarification.

JUDGE EPSTEIN: Anything else?

BY MR. MAGER:

Q. Mr. Rude, a couple of quick follow-up, what are intended to be "yes" or "no" questions on electric reliability, service quality and gas safety and reliability.

Has the Company proposed any commitments to improve performance in areas of electric reliability, service quality or gas safety and reliability as a result of the merger?

A. (Rude) That has to be "yes" or "no"?

Q. Yes.

MR. FITZGERALD: Your Honor, I am going to object to this. I think the question also goes beyond the scope of the redirect asked by Mr. Schwartz.

MR. MAGER: I don't believe so, Your Honor. Mr. Schwartz asked questions specifically about electric reliability, service quality and gas safety and reliability in terms of what may or may not happen going forward, or at least that's what the witness testified to.

MR. SCHWARTZ: Mr. Mager, I asked Mr. Rude specifically whether he had an opinion about whether any improvements were needed in those specific areas -- in those specific areas. And he provided that opinion. If you want to ask recross on his opinion, then I think that would be appropriate scope.

Q. In your opinion, has the Company made any commitments to improve electric reliability, service quality or gas safety and reliability?

MR. FITZGERALD: Your Honor, we are still going to just renew our objection to the question regardless of how it's reformulated.

MR. MAGER: Your Honor --

JUDGE EPSTEIN: I think it's a fair question. It may be relevant to whether there will be improvements.

Go ahead, Mr. Mager.

BY MR. MAGER:

Q. Has the Company made any commitments to improve its performance in electric reliability, service quality or gas safety and reliability as a result of the merger?

A. (Rude) Yes. In the unilateral acceptance documents for the document for the cooperatives in the Village of Sherburne, to the extent the task force that is developed resolves the concerns of those entities.

Q. When I was -- withdrawn.

Let me be more specific to the performance standards upon which the Company currently is measured quantitatively. Has the Company proposed any commitments to improve its performance in those areas in terms of electric reliability, service quality and gas safety and reliability as a result of the merger?

A. (Rude) Since this transaction does not affect those items, no.

Q. Has the Company proposed any commitments to prevent any deterioration or backsliding of its performance in those areas as a result of the merger?

A. (Rude) Indirectly through the -- through the commitment to maintain the same compensation and benefit levels and to not affect the employment levels.

Q. The Company has not agreed to any changes in terms of the specific performance standards themselves or the financial adjustments related to those standards, has it?

A. (Rude) No. They would continue to operate under the current ones.

Q. There was a question about Iberdrola's bond ratings versus that of Energy East. Do you recall that question on redirect?

And you indicated that as compared to Standard & Poor's when there is a one notch difference, Moody's and Fitch, the current difference is either two notches or three notches.

Do you recall that?

A. (Azagra) Yes.

Q. The -- to the extent the difference between Iberdrola and Energy East is greater, would that impact the spreads under which borrowings could be made or refinancings?

A. (Azagra) I think markets -- capital markets -- debt capital markets, in this case, take into account each specific issuance of debt securities, what is the current rating of that specific issuance at that time.

So I think when you issue debt in the debt capital market you will have term sheet in which you will say which is the rating of the Company which is issuing those bonds at that time.

And I think you will see the three ratings there. So the markets will assess where they would position those specific securities within that rating category. I think since those ratings are issued by a company which is part of -- will be part of a different company, I think the market will assess that.

Q. Is it your expectation that the market will allow Energy East to borrow money at a lower interest rate due to it being owned by Iberdrola?

A. (Azagra) As long as we keep rating differential our opinion is yes.

Q. And that -- and we testified earlier that until rates are reset those savings would not be returned to customers. That's your understanding?

MR. SCHWARTZ: I think, Your Honor, we are going past the scope of the redirect.

MR. MAGER: That was my final question, Your Honor. If I can get -- I will withdraw it and stick with the record on it.

JUDGE EPSTEIN: Any other cross? Anything further, Mr. Schwartz?

MR. SCHWARTZ: No, Your Honor. Thank you.

JUDGE EPSTEIN: Okay. Thank you, panel. You are excused. A discussion of scheduling off the record.

(DISCUSSION OFF THE RECORD.)

JUDGE EPSTEIN: We had a discussion about the offered witnesses.

STEVEN M. FETTER, after first having been duly sworn, was examined and testified as follows:

MR. JARED JOHNSON:

Q. Mr. Fetter, could you please provide your full name and address for the record.

A. Steven M. Fetter, F-E-T-T-E-R. And my address is 1489 West Warm Springs Road, No. 110, Henderson, Nevada, 89014.

Q. And do you have before you a 44-page document of questions and answers entitled, "Rebuttal Testimony of Steven M. Fetter," dated January 31, 2008?

A. Yes, I do.

Q. Was that document prepared by you?

A. Yes, it was.

Q. Mr. Fetter, do you have any corrections to your rebuttal testimony?

A. There is one typo on page 14 in footnote number 5. The very last exhibit cited in the sentence, "This report is attached hereto as exhibit" -- it says "SMF-2." It should be "SMF-3."

Q. Mr. Fetter, with that one correction, if I were to ask you the questions set forth in your rebuttal testimony today would your answers be the same as they were in the testimony?

A. Yes.

Q. Do you adopt this as your sworn rebuttal testimony in this proceeding?

A. Yes.

MR. JARED JOHNSON: Your Honor, may we have the rebuttal testimony of Steven M. Fetter copied into the record as if given orally.

JUDGE EPSTEIN: Yes, please.

(The following is the prefiled testimony of Steven M. Fetter:)

STEVEN M. FETTER

INTRODUCTION AND BACKGROUND

Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.

A. My name is Steven M. Fetter. I am President of Regulation UnFettered. My business address is 1489 W. Warm Springs Rd., Suite 110, Henderson, NV 89014.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

A. I am testifying on behalf of Iberdrola S.A., which I shall refer to as "Iberdrola" or the "Company".

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am President of Regulation UnFettered, a utility advisory firm I started in April 2002. Prior to that, I was employed by Fitch, Inc. ("Fitch"), a credit rating agency based in New York and London. Prior to that, I served as Chairman of the Michigan Public Service Commission ("Michigan PSC").

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I graduated with high honors from the University of Michigan with an A.B. in Communications in 1974. I graduated from the University of Michigan Law School with a J.D. in 1979.

Q. PLEASE BRIEFLY DESCRIBE YOUR ROLE AS PRESIDENT OF REGULATION UNFETTERED.

A. I formed a utility advisory firm to use my financial, regulatory, legislative, and legal expertise to aid the deliberations of regulators, legislative bodies, and the courts, and to assist them in evaluating regulatory issues. My clients include investor-owned, municipal and international electric, natural gas and water utilities, state public utility commissions and consumer advocates, non-utility energy suppliers, international financial services and consulting firms, and investors.

Q. WHAT WAS YOUR ROLE DURING YOUR EMPLOYMENT WITH FITCH?

A. I was Group Head and Managing Director of the Global Power Group within Fitch. In that role, I served as group manager of the combined 18-person New York and Chicago utility team. I was originally hired to interpret the impact of regulatory and legislative developments on utility credit ratings, a responsibility I continued to have throughout my tenure at the rating agency. In April 2002, I left Fitch to start Regulation UnFettered.

Q. HOW LONG WERE YOU EMPLOYED BY FITCH?

A. I was employed by Fitch from October 1993 until April 2002. In addition, Fitch retained me as a consultant for a period of approximately six months shortly after I resigned.

Q. HOW DOES YOUR EXPERIENCE RELATE TO YOUR TESTIMONY IN THIS PROCEEDING?

A. My experience as a Commissioner on the Michigan PSC and my subsequent professional experience analyzing the U.S. electric and natural gas sectors – in jurisdictions involved in restructuring activity as well as those still following a traditional regulated path – have given me solid insight into the importance of a regulator's role in setting rates, determining appropriate terms and conditions of service for all regulated utilities, and considering issues related to utility mergers and acquisitions. These are the factors that enter into the process of utility credit analysis and formulation of individual company credit ratings. It is a well-established fact that a utility's credit ratings have a significant impact as to whether that utility will be able to raise capital on a timely basis and upon favorable terms.

Q. HAVE YOU PREVIOUSLY SPONSORED TESTIMONY BEFORE REGULATORY AND LEGISLATIVE BODIES?

A. Since 1990, I have on numerous occasions testified before the U.S. Senate, the U.S. House of Representatives, the Federal Energy Regulatory Commission, and various state legislative and regulatory bodies on the subjects of credit risk within the utility sector, electric and natural gas utility restructuring, fuel and other energy adjustment mechanisms, utility mergers and acquisitions, utility securitization bonds, and nuclear energy. With regard to approval of utility mergers, I have previously testified on that issue on behalf of Cinergy Corporation, Cincinnati Gas & Electric Company, and Union Light, Heat and Power Company in their merger with Duke Energy Corporation before the Indiana Utility Regulatory Commission (in Case No. 42873), the Public Utilities

Commission of Ohio (in Case Nos. 05-732-EL-MER and 05-733-EL-AAM), and the Kentucky Public Service Commission (in Case No. 2005-00228).

My full educational and professional background is presented in Exhibit ___ (SMF-1).

Q. DOES YOUR TESTIMONY ADDRESS STAFF'S RESPONSES TO INFORMATION REQUESTS RELATED TO THE STAFF POLICY PANEL'S DIRECT TESTIMONY ADDRESSING THE ISSUES DISCUSSED IN YOUR TESTIMONY?

A. Yes. I have received and reviewed several responses by Staff to information requests related to the Staff Policy Panel's direct testimony and have specifically addressed some of the responses in my rebuttal testimony. However, additional analysis will be required to review and possibly specifically address many of Staff's responses as there was insufficient time to complete my review in the time provided to submit my testimony. I further note that in certain responses, Staff has indicated that it intends to revise certain exhibits and I reserve the right to modify my rebuttal testimony at hearing to address any changes to Staff's exhibits.

Q. ARE YOU SPONSORING ANY EXHIBITS?

A. Yes. In addition to my first exhibit, which is my educational and professional background, I sponsor the following: Exhibit __ (SMF-2) is an S&P Research publication entitled "U.S. Electric Utility Companies, Strongest to Weakest";

Exhibit __ (SMF-3) is an S&P research report entitled "U.S. Utilities Ratings Analysis Now Portrayed in the S&P Corporate Ratings Matrix"; Exhibit ___ (SMF-4) is a Moody's report entitled "Moody's downgrades Iberdrola to A3/P-2; Stable outlook"; Exhibit __(SMF-5) contains a copy of certain interrogatory responses referenced in this testimony; and Exhibit ___ (SMF-6) is an S&P Research Report entitled "Energy East Corp.," November 16, 2007.

EXECUTIVE SUMMARY

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. I have reviewed the prepared testimony of the New York Public Service Commission Staff Policy Panel ("Staff", "Policy Panel" or "PP") and will rebut the following views expressed by those individuals:

a) "Credit ratings are snapshots of a company's existing circumstances and by nature are subject to change when a company's circumstances inevitably change," (PP at 151), and that "S&P has put NYSEG and RG&E on watch for a downgrade if the transaction is completed." (PP at 167-168);

b) that reports by S&P and Moody's support the Policy Panel's belief that: "it is unlikely that the Company can sustain an "A" rating....Moreover,...the capital structure of Iberdrola is not consistent with an "A" rating currently and any increase in its leverage will make a downgrade or multiple downgrades more likely," (PP at 151-162), and that Iberdrola's latest strategic plan, including an extensive capital investment program, could lead to Iberdrola's ratings being downgraded, (PP at 163);

c) that Iberdrola's financial standing could make it more difficult for NYSEG and RG&E "to raise capital in the financial markets at reasonable terms," (PP at 164-165), and that S&P has "indicated specifically that bond rating downgrades for NYSEG and RG&E are likely if the transaction is approved." (PP at 167-168);

d) that "the Commission should insist on…ring fencing conditions" as a condition of approval of the merger, (PP at 174);

e) that "the investment community [has] rendered an assessment on Iberdrola's affect on NYSEG and RG&E" because NYSEG "issued debt 225 basis points above 10-year treasuries" while other companies issued debt at lower spreads (approximately 30 basis points lower compared to such treasuries), and the reasons the Policy Panel provides for the discrepancy in those spreads, (PP at 175-178);

f) the presence of Goodwill at Iberdrola as "an impediment to [Iberdrola's] credit quality," (PP at 179-193); and

g) the Policy Panel's discomfort with Iberdrola's capital structure and its potential impacts on ratemaking and credit ratings, (PP at 194-210).

STEVEN M. FETTER

CREDIT RATINGS OVERVIEW

Q. WHAT CREDIT RATINGS DO IBERDROLA, ENERGY EAST AND ITS REGULATED UTILITY SUBSIDIARIES CURRENTLY HOLD?

A. Iberdrola's current corporate (senior unsecured) credit ratings are "A-" from Standard & Poor's ("S&P") and the equivalent "A3" from Moody's. Both ratings have a Stable outlook. These ratings equate to mid-level investment-grade ratings. Fitch's issuer default rating for Iberdrola is 'A' with a Negative outlook. Energy East and its regulated subsidiaries, NYSEG and RG&E, currently hold corporate credit ratings of "BBB+" from S&P. At Moody's, Energy East holds a senior unsecured rating of "Baa2", while NYSEG and RG&E are rated at "Baa1". These ratings have a Negative outlook at both S&P and Moody's. At Fitch, Energy East's issuer default rating is 'BBB' with a Stable outlook; NYSEG is at 'BBB' with a Negative outlook; and RG&E is at 'BBB-' with a Stable outlook. The ratings of Energy East and its subsidiaries equate to low-to-mid-level investment-grade ratings.

Q. PLEASE GENERALLY DESCRIBE THE CREDIT RATINGS PROCESS.

A. Credit ratings reflect a credit rating agency's independent judgment of the general creditworthiness of an obligor or the creditworthiness of a specific debt instrument. While credit ratings are important to both debt and equity investors for a variety of reasons, their most important purpose is to communicate to investors the financial strength of a company or the underlying credit quality of a particular debt security issued by that company. Credit rating determinations are made through a committee process involving individuals with knowledge of a company, its industry, and its regulatory environment.

Corporate credit ratings analysis considers both qualitative and quantitative factors to assess the financial and business risks of fixed-income issuers. A credit rating is an indication of an issuer's ability to service its debt, both principal and interest, on a timely basis. It also at times incorporates some consideration of ultimate recovery of investment in case of default or insolvency.

Q. CAN YOU PROVIDE A BRIEF DISCUSSION ON WHY CREDIT RATINGS ARE IMPORTANT FOR REGULATED UTILITIES AND THEIR CUSTOMERS?

A. Yes. It is a well-established fact that a utility's credit ratings have a significant impact as to whether that utility will be able to raise capital on a timely basis and upon reasonable terms. As respected economist Charles F. Phillips stated in his treatise on utility regulation:

> Bond ratings are important for at least four reasons: (1) they are used by investors in determining the quality of debt investment; (2) they are used in determining the breadth of the market, since some large institutional investors are prohibited from investing in the lower grades; (3) **they determine, in part, the cost of new debt, since both the interest charges on new debt and the degree of difficulty**

in marketing new issues tend to rise as the rating decreases; and (4) they have an indirect bearing on the status of a utility's stock and on its acceptance in the market.[1] [Emphasis supplied.]

Thus, the lower a regulated utility's credit rating, the more the utility will have to pay to raise funds from debt and equity investors to carry out its capital-intensive operations. In turn, the ratemaking process factors the cost of capital for both debt and equity into the rates that consumers are required to pay. Thus, a utility with strong credit ratings is not only able to access the capital markets on a timely basis at reasonable rates, it also is able to share the benefit from those attractive interest rate levels with customers since cost of capital gets factored into utility rates.

Q. PLEASE DESCRIBE THE QUALITATIVE FACTORS USED BY THE RATING AGENCIES IN RATING UTILITY COMPANIES.

A. The most important qualitative factors include regulation, management and business strategy (including management's transparency, credibility, and ability to deliver upon its commitments), and access to energy, gas and fuel supply with recovery of associated costs.

Q. PLEASE EXPLAIN YOUR THOUGHTS ON THE IMPORTANCE OF REGULATION WITHIN THE CREDIT RATINGS PROCESS?

[1] C.J. Phillips, Pub. Utils. Reports, Inc., *The Regulation of Public Utilities, Theory and Practice* at 250 (1993). *See also* Public Utilities Reports Guide: "Finance," Pub. Utils. Reports, Inc. at 6-7 ("Generally, the higher the rating of the bond, the better the access to capital markets and the lower the interest to be paid.").

A. Regulation is a key factor in assessing the credit profile of a utility because a state public utility commission determines retail rate levels (recoverable expenses including depreciation and operations and maintenance, fuel cost recovery, and return on investment), the terms and conditions of service, and, in a case like this, the future structure of the utilities within its regulatory jurisdiction.

Since the mid-1990s when many states, including New York, introduced industry restructuring plans and opportunity for greater competition, regulation has become an even more important factor as the nature of a utility's responsibilities in providing energy services to customers has undergone dramatic change. In some states, industry restructuring was the result of plans formulated by the state legislature. In other states, the regulators, rather than the legislators, have determined the nature and pace of restructuring, or whether it would occur at all.

This situation thus affects utility investors' decisions because, before major investors will be willing to put forward substantial sums of money, they will want to gain comfort that regulators understand the economic requirements and the financial and operational risks of a rapidly changing industry and that their decision-making will be fair and will have a significant degree of predictability.

For these reasons, rating agencies look for the consistent application of sound economic regulatory principles by the commissions. If a regulatory body were to encourage a company to make investments based upon an expectation of the opportunity to earn a reasonable return, and then did not apply regulatory principles in a manner consistent with such expectations, investor interest in providing funds to such utility would decline, debt ratings would likely suffer, and the utility's cost of capital would increase.

Q. IN VIEW OF THE INDUSTRY CHANGES AND EVENTS DETAILED ABOVE, DO THE ACTIONS OF UTILITY REGULATORS TODAY DRAW EVEN MORE ATTENTION FROM THE FINANCIAL COMMUNITY?

A. Yes, without a doubt. Regulation has always garnered the attention of Wall Street, but, years ago, seemingly only during the days leading up to a commission's rate case decision. This began to change around the time that Fitch hired me in 1993 to serve in the role of regulatory analyst and assess regulatory, legislative and political factors that could affect a utility's financial strength. When California announced its ultimately ill-fated restructuring plan in 1994, the entire financial community, especially the rating agencies, took much greater notice of regulators and how they carried out their responsibilities, not only with regard to rate-setting, but even more importantly the manner in which they undertook to change the way the entire utility industry had operated for over 100 years.

S&P highlighted how the changing dynamics within the electric utility industry that I reference above have elevated the importance of regulation to the financial community:

> In recent years, [S&P's] emphasis on the decisions by state commissions has been less pronounced simply because so many

jurisdictions have been working through multiyear restructuring transition periods. During this time, rates were frequently frozen, and companies and customers have been adjusting (albeit with limited success) to the opportunity that customers have to choose alternate power suppliers. But the confluence of the approaching end of these transition periods and the growing need in certain regions of the country for significant resource additions is quickly returning the regulatory arena to center stage. In assessing the regulatory environment in which a utility operates, [S&P's] analysis is guided by certain principles, most prominently consistency and predictability, as well as efficiency and timeliness. For a regulatory scheme to be considered supportive of credit quality, commissions must limit uncertainty in the recovery of a utility's investment. They must also eliminate, or at least greatly reduce, the issue of rate-case lag that may prove detrimental if a utility needs rate relief.[2]

Q. COULD YOU PLEASE DESCRIBE THE QUANTITATIVE FACTORS USED BY THE RATING AGENCIES?

A. Yes. Financial performance continues to be a very important element in credit rating analysis. Credit rating agencies and fixed-income analysts utilize analytical ratios to understand the credit profile of a utility, with S&P publicly explaining the three

[2] S&P Research: "U.S. Utility Regulation Returns to Center Stage," April 14, 2005.

financial measures that it views as most important in its analysis of utility companies: Funds from Operations ("FFO") Interest Coverage; Funds from Operations / Total Debt; and Total Debt / Total Capital. While all three ratios are important, S&P has noted the agency's greater emphasis on cash flow measures, or the first two ratios: "Cash flow analysis is the single most critical aspect of all credit rating decisions."[3] Thus, as I address further below, the ratio most emphasized by the Staff Policy Panel -- Total Debt / Total Capital -- is the ratio given least emphasis by the rating agencies themselves. I note that rating agencies may adjust these key ratios to reflect imputed debt and interest-like fixed charges flowing from purchased power agreements and certain other off-balance sheet obligations.[4]

Building upon those key ratios, S&P has been the most explicit of the three major rating agencies in explaining how it views the interplay between quantitative and qualitative factors. As part of its utility credit rating process, S&P arrives at a "Business Risk Profile" designation that it considers in concert with its "Financial Risk Profile." Financial Risk is assessed based upon indicative ratios for the three key credit measures cited above; the weaker the Business Risk Profile designation, the stronger the financial ratios must be in order to support an investment-grade rating.

Q. WHAT DOES S&P'S BUSINESS RISK PROFILE DESIGNATION REFLECT?

[3] S&P Research: "A Closer Look at Ratings Methodology," November 13, 2006.
[4] *See, e.g.*, S&P Research: "Standard & Poor's Methodology for Imputing Debt for U.S. Utilities' Power Purchase Agreements," May 7, 2007.

A. The Business Risk Profile designation reflects S&P's assessment of qualitative factors such as regulation, markets, operations, competitiveness, and management. Interestingly, on November 30, 2007, S&P announced that it had inserted utility companies into its longstanding "Corporate Ratings" matrix, and that this new framework superseded its prior "Utility Financial Targets" matrix.[5] Thus, while previously S&P had measured business profiles on a '1' (meaning very strong) to '10' (meaning very weak) scale, going forward S&P will rank business risk as 'Excellent', 'Strong', 'Satisfactory', 'Weak', or 'Vulnerable'. However, it is important to note that S&P stated in its recent report announcing the change that "Regulated utilities and holding companies that are utility-focused virtually always fall in the upper range ("Excellent" or "Strong") of business risk profiles."[6] Thus, analysts using this new matrix will be faced with the seemingly anomalous situation that a utility designated as 'Strong' (or the second highest of the five business risk profile rankings) will actually reside within the lower half of all U.S utility business risk profiles, basically at a below average level. Similarly, under S&P's new framework, Financial Risk Profiles will be designated as 'Minimal', 'Modest',

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[5] The Policy Panel makes frequent reference (at pp. 154, 191, 199 and 266) to S&P's Research: "New Business Profile Scores Assigned for U.S. Utility and Power Companies; Financial Guidelines Revised," June 2, 2004. However, that research report and "Utility Financial Targets" matrix has been superseded by S&P Research: "U.S. Utilities Ratings Analysis Now Portrayed in the S&P Corporate Ratings Matrix," November 30, 2007, with a modified methodology process as explained in the text above. This report is attached hereto as Exhibit __ ~~(SMF-2)~~ (SMF-3).

[6] S&P Research: "U.S. Utilities Ratings Analysis Now Portrayed in the S&P Corporate Ratings Matrix," November 30, 2007. This report is attached hereto as Exhibit ___ (SMF-3).

'Intermediate', 'Aggressive', or 'Highly Leveraged', words that are not necessarily accurate descriptions of the strategies adopted by regulated utilities or the actions taken by their regulators.

Q. WHY IS S&P'S METHODOLOGY MEANINGFUL TO YOU?

A. I believe that S&P's methodology helps facilitate a general understanding of how a credit rating agency carries out the process of formulating a credit rating and the factors that go into such a determination.[7]

REBUTTAL OF POLICY PANEL TESTIMONY

Q. THE POLICY PANEL DESCRIBES CREDIT RATINGS AS "SNAPSHOTS OF A COMPANY'S EXISTING CIRCUMSTANCES" (PP AT 151) AND THAT S&P HAS PUT NYSEG AND RG&E ON WATCH FOR A DOWNGRADE IF THE TRANSACTION IS COMPLETED. IS THE PANEL ACCURATE IN ITS DESCRIPTIONS?

A. No, it is not. The Policy Panel professes to speak for how the financial community and the credit rating agencies will view Iberdrola, NYSEG and RG&E once the merger is consummated, but its understanding of the workings of credit rating agencies is deeply flawed.

[7] I focus here on S&P's ratings methodology, as opposed to those at Moody's or Fitch, due to the greater transparency of S&P's ratings process owing to its explanation of the methodology and how it is implemented in published reports. *See, e.g.*, S&P Research: "U.S. Utilities Ratings Analysis Now Portrayed in the S&P Corporate Ratings Matrix," November 30, 2007, and S&P Research: "U.S. Electric Utility Companies, Strongest to Weakest," November 30, 2007. For a comparison, see Moody's Research: "Rating Methodology: Global Regulated Electric Utilities," March 2005.

STEVEN M. FETTER

Q. PLEASE EXPLAIN THE FLAWS IN THE POLICY PANEL'S DISCUSSION OF CREDIT RATINGS?

A. Credit ratings are not, as the Policy Panel asserts, snapshots in time. Both S&P and Moody's publish definitions of their ratings, and related outlooks and watch status. S&P's definitions are as follows:

> A Standard & Poor's rating evaluates default risk over the life of a debt issue, incorporating an assessment of all future events to the extent they are known or can be anticipated. But we also recognize the potential for future performance to differ from initial expectations. Rating outlooks and CreditWatch listings address this possibility by focusing on the scenarios that could result in a rating change.
>
> Ratings appear on CreditWatch when an event or deviation from an expected trend has occurred or is expected, and additional information is necessary to take a rating action.... A listing does not mean a rating change is inevitable...
>
> A rating outlook is assigned to all long-term debt issuers and assesses the potential for a rating change. Outlooks have a longer time frame than CreditWatch listings – typically, two years – and incorporate trend or risks

with less certain implications for credit quality. An outlook is not necessarily a precursor of a rating change or a CreditWatch listing...

CreditWatch designations and outlooks may be "positive," which indicates a rating may be raised, or "negative," which indicates a rating may be lowered..."Stable" is the outlook assigned when ratings likely will not be changed, but it should not be confused with expected stability of the company's financial performance...

Issuer ratings...focus entirely on the default risk of the entity. Long-term issue ratings also take into account risks pertaining to loss-given-default...both the issuer and issue rating definitions are expressed in terms of default risk, which refers to the capacity and willingness of the obligor to meet its financial commitments on time, in accordance with the terms of the obligation.[8]

Q. HOW DOES S&P DEFINE THE RATING CATEGORIES AT ISSUE WITHIN THIS PROCEEDING: "A" AND "BBB"?

A. S&P defines those categories as follows:

[8] S&P Research: "Corporate Ratings Criteria – Standard & Poor's Role in the Financial Markets; Ratings Definitions; The Rating Process," March 9, 2006.

'A': An obligation rated 'A' is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rated categories. However, the obligor's capacity to meet its financial commitment on the obligation is still strong.

'BBB': An obligation rated 'BBB' exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.[9]

Q. DOES MOODY'S VIEW THE SITUATION SIMILARLY?

A. Yes, it does. Moody's states that:

Long-term obligation ratings are opinions of the relative credit risk of fixed-income obligations with an original maturity of one year or more. They address the possibility that a financial obligation will not be honored as promised...

Issuer Ratings are opinions of the ability of entities to honor senior unsecured financial obligations and contracts.

[9] *Id.*

A Moody's rating outlook is an opinion regarding the likely direction of an issuer's rating over the medium term. Where assigned, rating outlooks fall into the following four categories: Positive, Negative, Stable, and Developing....

Moody's uses the Watchlist to indicate that a rating is under review for possible change in the short-term.[10]

Q. AND HOW DOES MOODY'S DEFINE THE 'A' AND 'BBB' CATEGORIES?

A. Moody's defines them as:

"Obligations rated A are considered upper-medium grade and are subject to low credit risk."

and

"Obligations rated Baa are subject to moderate credit risk. They are considered medium-grade and as such may possess certain speculative characteristics."[11]

Q. BASED UPON THOSE DEFINITIONS, WHAT DO YOU GLEAN FROM THE POLICY PANEL'S COMMENTS NOTED ABOVE?

A. It is clear that S&P and Moody's do not view their credit rating determinations as "snapshots" of an existing moment in time, and this is confirmed by my experience

[10] "Moody's Rating Symbols and Definitions," March 2007.

[11] *Id.*

as head of the utility ratings practice at Fitch. When assigning a rating, we would convene a rating committee, consider both qualitative and quantitative factors (including financial forecasts), and come to our best judgment as to the appropriate rating for a security until its maturity. As noted, at the time of assignment of a rating, an outlook is provided to indicate the potential direction of a rating's movement during the medium-term, usually two to three years. If an unforeseen event were to occur that could affect the rating during the near-term (usually six to twelve months), then a Watch designation is assigned, usually with the likely direction of rating movement indicated.

Q. IS IT THE S&P NEGATIVE "*WATCH*" DESIGNATION ON NYSEG AND RG&E THAT THE POLICY PANEL IS CONCERNED ABOUT?

A. It would appear that that is what is troubling the Policy Panel (*see*, *e.g.*, PP at 167), but such concerns are misplaced. Both NYSEG and RG&E currently have Negative *outlooks* assigned to their ratings by S&P and Moody's, not, as Staff appears to indicate, Negative Watch designations.[12] This would signal *potential* negative movement over a two to three year horizon – a time period that is likely to be well beyond when the Commission decides whether to approve this merger or not. The Policy Panel concedes (PP at 167) that the Negative "watches" (which should be "outlooks") relate to both the regulatory climate within New York State relating to

[12] In some parts of their testimony, the Policy Panel seems to confuse a negative "outlook" with a negative "watch". *Compare* PP at 158 (referring correctly to a negative "outlook") *with* PP at 167 (referring to a "watch for a downgrade").

NYSEG and RG&E, along with the Commission's consideration of the Iberdrola – Energy East merger. In view of the assignment of a (medium-term) outlook rather than a (near-term) Watch designation, I believe the Negative outlook relates primarily to the regulatory climate within the state as it pertains to Energy East and its subsidiaries over the next few years, supplemented by issues that have arisen of late related to the regulatory review of the merger (rather than the merits of the transaction itself). It is no coincidence that the rating agencies put these Negative outlooks in place in September 2006, following the issuance of the Commission's electric rate decision for NYSEG. As described below, the August 2006 rate order precipitated these Negative outlooks.

Q. THE POLICY PANEL INDICATES THAT S&P AND MOODY'S REPORTS POINT TO A LIKELY DOWNGRADE OF IBERDROLA OUT OF THE 'A' CATEGORY, WITH THE POTENTIAL FOR MULTIPLE DOWNGRADES. IS THIS WHAT THE REPORTS SAY?

A. No, they do not. The Policy Panel misinterprets the S&P and Moody's reports by focusing only on the risks cited by the rating agencies in their reports, without balancing them against the positive aspects of Iberdrola cited in those same reports. This one-sided interpretation of the S&P and Moody's reports is not an appropriate basis upon which to conclude that the subject transaction will be harmful. Every utility faces risks – to consider only negative factors provides a skewed perspective about a company and leads one to make inaccurate assumptions about credit ratings, as has happened here. Rating agencies deliberate over all qualitative and quantitative factors relevant to a company's credit ratings, and then publish credit ratings and factors supporting those determinations to provide investors, other interested parties, and the general public with full information about those ratings. A rating agency speaks through its publicly disseminated press releases and reports.

Q. IS THERE ANY MERIT TO THE POLICY PANEL'S CONTENTION (PP AT 159) THAT, BY THE STANDARDS OF AN S&P REPORT (EXHIBIT PP-17), IBERDROLA'S PRO FORMA DEBT RATIO IMPLIES A 'BBB' BOND RATING?

A. No, there is not. The Staff Policy Panel has taken one ratings criterion, the Total Debt / Total Capital ratio, and elevated it to become, in Staff's view, the sole relevant criterion for credit ratings -- an approach that is manifestly contrary to the multiple criteria that credit ratings agencies carefully weigh and examine before assigning a rating (in this case, for example, Iberdrola's 'A-' rating from S&P). As I discussed above, S&P has explained that (i) Funds from Operations ("FFO") Interest Coverage and (ii) Funds from Operations / Total Debt are the two most important financial measures used to rate companies' debt which, of course, explains why Iberdrola is not and should not, as Staff suggests, be rated 'BBB'. Iberdrola has coverage ratios commensurate with an 'A' category rating.[13]

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[13] *See* S&P Research Update: "Spain's Iberdrola Affirmed at 'A-/A-2' on IPO Completion; L-T Off Watch; Outlook Stable," December 13, 2007 ("The IPO proceeds will finance this growth

Interestingly, under its new methodology (announced in November 2007), S&P has classified NYSEG and RG&E as having Excellent business profiles and Aggressive financial profiles.[14] Under that updated methodology, S&P equates such profiles with a 'BBB' rating.[15]

Q. PLEASE DESCRIBE FURTHER YOUR ANALYSIS OF THE S&P AND MOODY'S REPORTS AS THEY PERTAIN TO THE POTENTIAL FOR A FURTHER CREDIT RATING DOWNGRADE OF IBERDROLA?

A. A review of the most recent public pronouncements by S&P and Moody's on Iberdrola presents a very different picture than the one presented in the Policy Panel's testimony. On December 13, 2007, S&P affirmed its 'A-' corporate credit rating on Iberdrola, removing it from Negative CreditWatch, and assigning a Stable outlook. The rating action followed upon successful completion of the IPO of

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and are key to maintaining credit metrics that are consistent with an 'A-' rating....Credit metrics should remain in line with the levels indicated."). The report is attached as an exhibit to the Joint Petitioners' Policy Panel. *See also* Moody's Investors Service: "Moody's downgrades Iberdrola to A3/P-2; Stable outlook," December 12, 2007 ("Moody's expects Iberdrola's ratios to be positioned at the low end of the expected range for an A3 rating for a company with this business risk profile...these ratios are anticipated to improve gradually."). This report is attached hereto as Exhibit ___ (SMF-4).

[14] *See* Exhibit ___ (SMF-2) (S&P Research: "U.S. Electric Utility Companies, Strongest to Weakest").

[15] *See* Exhibit ___ (SMF-3) (S&P Research: "U.S. Utilities Ratings Analysis Now Portrayed in the S&P Corporate Ratings Matrix").

Iberdrola Renovables, with the proceeds slated to secure the Company's financial profile during the period of its new strategic capital investment plan (2008-2010).[16]

Unlike the Policy Panel's testimony, S&P detailed the balance between positive and negative rating factors:

> The ratings reflect Iberdrola's strong position as one of Spain's dominant vertically integrated electricity utilities and the regulated and quasiregulated nature of its electricity distribution and renewable operations, respectively, which together contribute about 40% of EBITDA and provide cash flow stability and predictability. They also reflect the group's increased earnings diversity – both geographic and operational – through the acquisition of Scottish Power…
>
> These strengths are offset by increasing competitive pressure in the Spanish electricity market, Iberdrola's exposure to electricity price volatility, and the group's weaker capital structure resulting from the Scottish Power deal. In addition, Iberdrola must now face the challenge of integrating the acquired business.

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[16] S&P Research Update: "Spain's Iberdrola Affirmed at 'A-/A-2' on IPO Completion; L-T Rating Off Watch; Outlook Stable," December 13, 2007.

> Iberdrola is one of the world's largest energy companies...Over the next three years, Iberdrola will undertake a large investment program of 24.2 billion euros...Renewable energy will represent the core of the group's future growth, and accounts for about 50% of expected organic investments. The IPO proceeds will finance this growth and are key to maintaining credit metrics that are consistent with an 'A-' rating.[17]

Q. HOW DOES S&P VIEW THE BALANCE BETWEEN POSITIVE AND NEGATIVE FACTORS?

A. S&P assigned a Stable outlook to Iberdrola's ratings. The agency explained its conclusion:

> The stable outlook reflects [S&P's] expectations that Iberdrola will focus on consolidating its operations and that its management will be consistent with its commitment to strengthen the group's capital structure. Credit metrics should remain in line with the levels indicated. The ratings could be lowered if credit metrics are weaker than anticipated because of lower profit margins, large acquisitions, or a more aggressive dividend policy. Changes to the regulatory framework for renewable energies (rate-of-return reduction, elimination of tax credits) would also have a negative impact on the rating. An upgrade is unlikely in the short term.[18]

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[17] *Id.*

[18] *Id.*

All in all, S&P, through its assignment of a Stable outlook, sees relative stability for Iberdrola's ratings over the next couple of years, at rating levels above those of Energy East.

Q. HOW DO THE MOODY'S REPORTS DESCRIBE IBERDROLA'S CURRENT SITUATION?

A. In very similar fashion. On December 12, 2007, Moody's downgraded Iberdrola from an 'A2' rating to 'A3'. In doing so, Moody's stated that the downgrade incorporated "the partly debt-funded acquisition of Scottish Power in April 2007; the recently announced IPO of Iberdrola's renewables subsidiary…; and an ambitious investment strategy for 2008-2010 [that includes] the expected acquisition of Energy East Corporation…, subject to regulatory approvals."[19] On December 13, 2007, Moody's published a report on Iberdrola, citing the Company's business strengths and weaknesses, and, like S&P, emphasized several positive aspects of the business profile of Iberdrola while affirming a Stable outlook:

> Iberdrola's A3/P-2 ratings reflect Moody's overall low/medium assessment of Iberdrola's business risk for an electric utility, following the recent corporate actions and taking into account its revised strategic plan. This risk assessment reflects the significantly increased scale of the group, its

[19] *See* Exhibit ___ (SMF-4) ("Moody's downgrades Iberdrola to A3/P-2; Stable outlook").

geographic spread and diversification of risks, particularly those of regulation, generation pricing and fuel technology…

Nonetheless, this risk assessment factors a degree of integration and execution risk as the company has expanded into new markets in which it has had less prior experience, and, in addition, the group has ambitious growth targets which may not be achieved if operating conditions become more difficult…

Iberdrola is well-placed to make good progress given its size, scale and diversified exposure to fairly favourable regimes in Iberia, the UK and US. It has long-term agreements with a range of turbine manufacturers; an experienced team in the development of sites and management of operations which should help offset key risks that include the speed at which the pipeline can be processed given possible delays in receiving permissions and/or accessing equipment; possible regulatory change; construction risk and weather conditions…

Ambitious growth targets in the UK may be challenged by competitive activity and there are a number of regulatory and political challenges in Spain as the electricity system is transitioning only gradually to a fully

> liberalized market. Overall, commodity and generation pricing risks remain the most volatile component of the group's portfolio although these are somewhat limited by the vertical hedge of the UK and Spanish operations and the various hedging and risk-mitigating techniques Iberdrola employs.[20]

Q. HOW DOES MOODY'S VIEW THE BALANCE BETWEEN POSITIVE AND NEGATIVE FACTORS?

A. Moody's assigned a Stable outlook to Iberdrola, explaining that:

> The rating outlook is stable although Iberdrola's ratios are expected to be positioned at the low end of the rating range for the A3 rating category applied for its business risk... Should the company fail to achieve growth targeted, or should negative regulatory or pricing developments affect the company, then pressure could develop on these ratios. Nonetheless, Moody's believes the company is committed to an A3 rating and that it would consider means at its disposal to reinforce its financial position if necessary.[21]

The 'A3' rating is equivalent to S&P's 'A-' rating, and Moody's has matched S&P's Stable outlook, signifying relative stability for the medium term.

Q. IN ITS RESPONSE TO REQUEST FOR INFORMATION IBER/EE IR NO. 27 (EXHIBIT __ (SMF-5), THE POLICY PANEL NOTES THAT IBERDROLA

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[20] Moody's Global Credit Research: "Credit Opinion: Iberdrola S.A.," December 13, 2007 (attached as an exhibit to the Joint Petitioners' Policy Panel).

[21] *Id.*

CURRENTLY HAS A "CREDIT DEFAULT SWAP-IMPLIED" CREDIT RATING OF Baa1 AND A "DEFAULT PREDICTOR-IMPLIED" CREDIT RATING OF Baa2, BOTH ASSIGNED BY MOODY'S. DOES THIS MEAN THAT IBERDROLA'S MOODY'S CREDIT RATINGS EQUATE TO EITHER Baa1 OR Baa2?

A. No, Iberdrola's Moody's credit ratings do not. Moody's has explained that such implied ratings are *not* an input into credit ratings decisions themselves, but rather are functions of comparing its assigned credit ratings to measures calculated as a result of bond and swap market trading levels and certain financial accounting ratios – all for the purpose of providing the investor with as much raw data as the rating agency can. Moody's itself clearly distances the process of assigning its credit ratings from the numerical calculations underlying the two implied "ratings" identified by Staff:

> **For bond-implied ratings and credit default swap-implied ratings, gaps and movements of one or two notches are generally not significant for** several reasons. First, one notch differences are often attributable to "rounding error." At some point, a cutoff must be made for what constitutes, for instance, an A2 credit. For credits close to this cutoff, small fluctuations in market pricing could drive the market implied rating in line with Moody's rating one day and away from it the next.

Second, the spreads used to infer bond-implied ratings or credit default swap-implied ratings may be influenced by non-credit factors, such as liquidity risk.

Third, in many cases, credit spreads and credit default swap spreads are representative indicative quotes that may be an imperfect indicator of a security's likely trading price....

Moody's analysts use these tools to identify where there are material and systematic gaps between our ratings and the ratings implied by market data or financial accounting ratios. **They use them to inform themselves of how their opinions differ from those held by the broader market or those generated by purely quantitative models, so that they are prepared to clearly articulate the reasons for those differences to market participants. Market implied ratings are not, however, an "input" into their rating decisions.**

Market-based measures are inherently volatile and produce many false positives and false negatives. We remain committed to producing opinions that look beyond each day's news to provide much more stable, although equally predictive, measures of long-term credit risk. [Emphasis supplied.][22]

Thus, far from pointing to the direction that Iberdrola's credit ratings will be going, the two implied "ratings" identified by the Policy Panel are either insignificant indicators or have led the Moody's analysts to look even more closely at the factors leading the agency to assign an 'A3' rating to Iberdola with a Stable outlook.

Q. THE POLICY PANEL EXPRESSED CONCERN THAT IBERDROLA'S EXTENSIVE CAPITAL INVESTMENT PROGRAM COULD LEAD TO A DOWNGRADE OR MULTIPLE DOWNGRADES (*SEE, E.G.*, PP AT 169). CAN YOU ADDRESS ITS CONCERN?

A. As can be seen in the rating agency reports cited above, S&P and Moody's have fully incorporated Iberdrola's strategic plan into their current ratings and outlooks. It is my understanding that Iberdrola has consistently stated its commitment to maintaining an 'A' category rating before and after announcement of its strategic investment plan. The Company's recent steps show that it has strong ability to access the capital markets when necessary, and, indeed, Iberdrola has already issued the equity needed to finance the acquisition of Energy East, as well as concluding a successful IPO that will provide the bulk of the funding needed for the strategic plan.

[22] Moody's Products and Services: "Market Implied Ratings: Frequently Asked Questions," September 2006.

What should be clear is that, if Iberdrola is able to continue its strong past performance and maintain its commitment to having an 'A' category rating, both of which the rating agencies believe the Company can do, S&P and Moody's do not see that the capital investment plan will threaten the stability of Iberdrola's current credit rating level.

Q. THE POLICY PANEL WARNS THAT IBERDROLA'S FINANCIAL STANDING COULD HARM NYSEG'S AND RG&E'S ACCESS TO THE CAPITAL MARKETS AND THAT S&P HAS INDICATED THAT RATING DOWNGRADES ARE LIKELY FOR NYSEG AND RG&E IF THE MERGER IS APPROVED (PP AT 167-168). COULD YOU ADDRESS THESE COMMENTS?

A. Yes. First, when the merger was announced, both S&P and Moody's affirmed their ratings on Energy East, NYSEG, and RG&E and maintained the existing Negative outlooks -- thus, there was *no change* to the companies' ratings following the transaction's announcement. Second, Iberdrola's 'A-/A3' ratings are higher than those of Energy East at 'BBB+/Baa2' and its subsidiaries at 'BBB+/Baa1'. When you factor in Iberdrola's Stable outlook versus Energy East's and its subsidiaries' Negative outlooks, investors are looking at basically a one-and-a-half notch rating differential between Iberdrola and NYSEG/RG&E and a one-and-a-half to two-and-a-half notch difference between Iberdrola and Energy East. Such differential in ratings is significant. Indeed, in view of Iberdrola's stated commitment to maintain its rating status in the 'A' category, the greater likelihood is that once the merger has been approved and a successful transition has concluded, the affiliation with the 'A-' rated Iberdrola might allow Energy East, NYSEG and RG&E to escape their Negative outlooks and potentially improve their ratings to Iberdrola's level. S&P described such a situation in its 2005 "Corporate Ratings Criteria:"

> A weak entity owned by a strong parent usually – although not always – will enjoy a stronger rating than it would on a standalone basis. Assuming the parent has the ability to support its subsidiary during a period of financial stress, the spectrum of possibilities still ranges from ratings equalization at one extreme to very little or no help from the parent's credit strength at the other. The greater the gap to be bridged, the more evidence of support is necessary."[23]

Here, it is important to note that Iberdrola's cash flow coverages are markedly stronger than those of Energy East. For example, for 2006, Iberdrola's FFO interest coverage was 3.9x compared to Energy East at 2.7x. Iberdrola's FFO/Total Debt ratio was 18.5% as compared to Energy East at 14.2%. These

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[23] S&P Research: "Corporate Ratings Criteria: Rating Methodology," June 9, 2005. *See also* Moody's Credit Opinion: "Energy East Corporation," December 26, 2007 ("Moreover, if Iberdrola is successful in acquiring EEC and then takes aggressive steps to reduce structural subordination by lowering or eliminating debt at the EEC and/or other operating company levels, then such a strategy could at least help stabilize the outlook for EEC and the rated subsidiaries within the current EEC family. Indeed, depending on the magnitude, such steps might even contribute to higher ratings for some of the lower rated entities in the current EEC family (i.e. those with senior unsecured debt rated Baa1 or lower.").

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differences are significant and could serve to support improved ratings at Energy East.[24]

Turning to the Policy Panel's following comment about S&P's intentions (PP at 167-168):

> Q. Have either credit agency indicated specifically that bond rating downgrades for NYSEG and RG&E are likely if the transaction is approved?
>
> A. Yes, Exhibit __ (PP-4) contains two reports from S&P, one for NYSEG and the one for RG&E. These reports express concern over the financial metrics, i.e., the high debt leverage; Iberdrola would exhibit as the ultimate parent of NYSEG and RG&E. These reports also expressed some concern over the last NYSEG rate decision, which lowered the Company's rates. As a result of these concerns and others, S&P has put NYSEG and RG&E on watch for a downgrade if the transaction is completed.

I earlier discussed the inaccuracy in the Panel's use of the phrase "watch for a downgrade."

Q. DO YOU HAVE OTHER CONCERNS WITH THE STATEMENTS BY STAFF QUOTED ABOVE?

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[24] S&P Research: "Iberdrola, S.A.," September 18, 2007 (attached to the Staff Policy Panel as Exhibit __(Policy Panel – 15); S&P Research: "Energy East Corp.," November 14, 2007, attached hereto as Exhibit ___ (SMF-6).

A. Yes. Unfortunately, the Staff, in describing the S&P report, explicitly, or, at a minimum, implicitly misleads the Commission with regard to S&P's placement of a Negative outlook on NYSEG and RG&E. That action did not occur upon announcement of the Iberdrola-Energy East merger on June 26, 2007. Rather that action came almost a year earlier, on August 25, 2006, and was "based on the [NYPSC's] decision to approve a one-year rate plan that reduces [NYSEG's] electric delivery rates by $36.2 million annually starting in January 2007....[a decision that] will pressure credit measures in 2007, which were already expected to be weak for the ratings." S&P concluded, "An outlook revision to stable is not anticipated in the near term, given the need for regulatory relief that is unlikely to occur before 2008."[25]

The announcement of the merger did add nuance to S&P's outlook, but in no way reached the level of a "watch for a downgrade if the transaction is completed." In the November 14, 2007 report cited by the Policy Panel, S&P indicated that:

> The negative outlook indicates that ratings could be lowered one notch depending on Iberdrola's ultimate financing structure for the acquisition. Moreover, potential regulatory outcomes that could hurt cash flow metrics would precipitate lower ratings. Ratings stability at the current level is highly dependent on a balanced capital approach at Energy East, consistent

[25] S&P Research Update: "Energy East and Units Outlook Revised to Negative After New York Regulators Cut Unit's Rates," August 25, 2006.

> cash flow metrics, and supportive regulatory outcomes. Higher ratings are limited by the company's persistent high debt.[26]

Q. DID MOODY'S EXPRESS A VIEW ON THIS QUESTION?

A. Yes, it did. On December 26, 2007, Moody's stated that its Negative outlook on Energy East and its subsidiaries:

> reflects the consolidated financial and operating challenges that exist within the consolidated family. These challenges primarily result from the outcome of the affiliated NYSEG's general rate case in August 2006 plus the uncertainties about whether the modified fixed price option approved earlier this year by the NYPSC for NYSEG's retail electric customers can provide sufficient impetus for overcoming some of these challenges....In addition, the negative outlook recognizes the aforementioned pending transaction with Iberdrola.[27]

Q. HOW DO YOU READ THE COMMENTS FROM S&P AND MOODY'S IN THESE REPORTS?

A. That the clear precipitating event for the Negative outlooks was the August 2006 rate order, and that the rating agencies did not see a potential positive resolution to the problem until another rate proceeding could occur, perhaps by 2008. Already existing financial and operating challenges "primarily result[ing]" from regulatory

[26] S&P Research: "New York State Electric & Gas Corp.," November 16, 2007.

[27] Moody's Global Credit Research: "Credit Opinion: Energy East Corporation," December 26, 2007.

risks faced by NYSEG in New York continued to be key to the rating agencies' analyses – through that language, Moody's clearly characterizes this as the primary challenge. The Iberdrola-Energy East merger was laid onto this difficult regulatory situation, and, by necessity, has become part of the rating agencies' overall vigilant posture in light of the possible regulatory action associated with this proceeding, as opposed to the business merits of the transaction. But by no means has S&P or Moody's validated the Policy Panel's statement that NYSEG and RG&E are "on watch for a downgrade if the transaction is completed."

Q. WOULD YOU SUPPORT THE POLICY PANEL'S CALL (PP AT 174, 206) FOR THE COMMISSION TO INSIST UPON RING FENCING PROVISIONS AS A CONDITION OF MERGER APPROVAL?

A. I would not support such conditions as part of merger approval here based upon ratings or rating agency reports. While effective ring fencing can isolate the risks of individual subsidiaries in a corporate family, the Commission must be mindful that this can cut both ways. Ring fencing can also concentrate risks within subsidiaries of a corporation. For example, a poor regulatory decision or a decline in sales could leave a subsidiary financially reeling without access to the broader corporate safety net. Basically, a financially strong holding company's ability to support a weaker performing subsidiary could be compromised if strong ring fencing were to be put in place.

Here, Iberdrola is a global leader among electric utilities. It has a wide geographic reach and significant business operational diversity, including substantial experience interacting with regulators and public officeholders. The Company has a stronger credit profile than Energy East, NYSEG and RG&E, and can access the capital markets – both equity and debt – more easily and upon more reasonable terms. Moreover, one major benefit of such a merger would be the ability to tap into an extensive base of management expertise. In view of all of these beneficial characteristics that Iberdrola brings to the table – and the negative side to ring fencing restrictions discussed above, I believe it would be a mistake to create hard and fast rules restricting, if not prohibiting, financial and operational interaction between Iberdrola and Energy East and its subsidiaries.[28]

Q. THE POLICY PANEL STATES THAT "THE INVESTMENT COMMUNITY [HAS] RENDERED AN ASSESSMENT ON IBERDROLA'S AFFECT ON NYSEG AND RG&E" BECAUSE, AS SHOWN ON EXHIBIT PP-19, NYSEG ISSUED DEBT 225 BASIS POINTS ABOVE 10-YEAR TREASURIES ON NOVEMBER 29, 2007, APPROXIMATELY 30 BASIS POINTS HIGHER THAN DEBT ISSUED BY OTHER SIMILAR COMPANIES WITHIN THE SAME TIMEFRAME. DO YOU AGREE WITH THIS ASSESSMENT?

[28] *See* Fetter, Steve, "Perspective: Don't Fence Me Out," Public Utilities Fortnightly, October 2004 ("Hard-and-fast ring-fencing rules are not the best way to maintain order in the partially deregulated utility sector.").

A. No, I do not, for the reasons discussed in the rebuttal testimony of the Rate Adjustment Panel.

Q. CAN YOU COMMENT UPON THE POLICY PANEL'S BELIEF THAT THE AMOUNT OF GOODWILL AT IBERDROLA WILL HAVE A NEGATIVE EFFECT ON ITS CREDIT RATINGS?

A. "Goodwill" is the excess price paid over and above book value of tangible assets. Goodwill has been accumulated on Iberdrola's balance sheet in large part from its acquisition of Scottish Power with more to go on its books upon completion of the pending merger with Energy East. Goodwill is subject to an annual impairment test and is subject to possible write-down, as are all assets, whether tangible or intangible. Goodwill occurs when accounting principles do not allow for write-up of an asset to its apparent true value. Rating agencies do not view Goodwill as a primary indicator of the risk profile of a company, and the lack of focus on Goodwill by S&P and Moody's in their reports on the proposed merger bears this out.

Instead, cash flow will be the driver of Iberdrola's ratings, as it will be in the assessment of Goodwill impairment. Accordingly, if Iberdrola is able to maintain its strong operational performance while continuing to properly manage its business risks, which the rating agencies expect it to be able to do, its credit ratings should be stable and the potential for Goodwill impairment should be small. It is only when Goodwill impairment poses a threat to a company's capital structure that rating agencies will focus upon potential negative credit profile effects. The rating agencies have not indicated the need to do so here.

Q: IN ITS RESPONSE TO REQUEST FOR INFORMATION IBER/EE IR NO. 51 (EXHIBIT __ (SMF-5), STAFF STATES THAT "WHILE NOT MENTIONED IN ANY REPORT, STAFF BELIEVES IT IS NOT A COINCIDENCE THAT IBERDROLA'S GOODWILL HAS RISEN AS ITS CREDIT QUALITY HAS DECLINED," AND THEN DESCRIBES THIS HIDDEN MOTIVE IT HAS UNCOVERED AS "EVIDENCE." "THEREFORE," THE STAFF CONCLUDES, "EVIDENCE INDICATES THAT GOODWILL IS PLAYING A ROLE IN THE CREDIT QUALITY DECLINE OF IBERDROLA." DO YOU AGREE WITH THIS CONCLUSION?

A: No, I do not. Rating agencies do not base reported credit ratings on factors that are not mentioned in their reports. They explain the strengths and weaknesses underlying a company's credit ratings as has been fully explored within the agency reports and the testimony in this case. If Goodwill was the driver of a credit profile decline for Iberdrola or any other rated entity, all three rating agencies would mention it, rather than none.

Q: STAFF SUGGESTS THAT GOODWILL BE TREATED AS SIMILAR TO DEBT LEVERAGE (PP AT 255). DO YOU AGREE WITH THIS SUGGESTION?

A: No, I do not. Goodwill is not debt and it should not be treated as such. Goodwill is not included in a rating agencies' calculation of debt leverage,[29] just as it is not included in a regulatory commission's assessment of capital structure as it relates to ratemaking activities. As I stated above, it is only when Goodwill impairment poses a threat to a company's capital structure that rating agencies will focus upon potential negative credit profile effects, though they still do not treat impaired Goodwill as debt.

Q. THE POLICY PANEL'S RATEMAKING AND RATINGS DISCUSSIONS HAVE A HEAVY FOCUS ON IBERDROLA'S CAPITAL STRUCTURE. DO THEIR ARGUMENTS CAUSE CONCERN FOR YOU?

A. I believe that focus is misplaced. First, NYSEG and RG&E will maintain a capital structure that is regulated by the NYPSC. At the same time, these utilities could benefit from the higher credit ratings at Iberdrola. Indeed, over time, all other things being equal, the superior ratings and financial standing of Iberdrola should have a

[29] For example, S&P defines Total Debt to Total Capitalization as "Long-term debt (including amount for operating lease debt equivalent) plus current maturities, commercial paper, and other short-term borrowings" divided by "Long-term debt (including amount for operating lease debt equivalent) plus current maturities, commercial paper, and other short-term borrowings plus shareholders' equity (including preferred stock) plus minority interest." *See* S&P Research: "Corporate Ratings Criteria," 2000. Similarly, Fitch defines "Debt as % of Total Capitalization" as "Total debt (short- and long-term debt), including debt of financing trusts or debt supporting trust preferred securities, plus current portion of long-term debt and capitalized lease obligations" divided by "Total debt (short- and long-term debt), including debt of financing trusts or debt supporting trust preferred securities, plus current portion of long-term debt and capitalized lease obligations plus preferred and preference stock plus common equity." *See* Fitch Research: "U.S. Electric and Gas Financial Peer Study," May 2007.

positive impact on the credit ratings of Energy East and its two regulated subsidiaries.

As for how Iberdrola's capital structure could affect its ratings, I emphasize again that the primary concern of both rating agencies and investors is the ability of an issuer to pay interest and principal when due. As a result, and as explained above, the most important quantitative metrics in the ratings process are cash flow measures that relate directly to such ability to meet financial commitments on a timely basis. Such focus can clearly be seen in the rating agencies' reactions to the NYPSC's August 2006 rate order for NYSEG. The Negative outlooks that were placed on Energy East and its subsidiaries in August 2006 were driven by the cash flow implications of the Commission decision. Energy East's capital structure was unaffected by that rate order, and subsequently, in March 2007, Energy East's capital structure was improved through the issuance of 10 million shares of common equity. Yet the Negative outlooks remain – and the rating agencies remain focused on Energy East's cash flow.

Finally, on December 13, 2007, both S&P and Moody's indicated comfort with Iberdrola's debt level. Moody's stated that steps Iberdrola has taken related to its Scottish Power and Energy East acquisitions, and divestments including its successful IPO "should allow the company to stay within its leverage target of

50%."[30] S&P on that same day said that the proceeds from the IPO "will enable the group to maintain gearing below 50%."[31]

CONCLUSION

Q. DO YOU HAVE CONCLUDING THOUGHTS?

A. Yes. The concept of utility regulation is to provide a surrogate for the competitive market that is not present when a company possesses monopoly or near-monopoly status with regard to an essential good, such as utility service. Based on my experience as a state regulator, it is not the purpose of regulators to step into the shoes of management and make strategic business decisions. Nor is it the role of regulators to usurp the function of the major rating agencies and determine likely rating impacts different than those highlighted by the agencies. The Staff Policy Panel attempts to do both of these things here. The NYPSC should focus on preserving the financial and operational health of the two regulated utilities within its jurisdiction. That decision is easier here than in most cases because Iberdrola has indicated its intent to take the necessary steps to maintain both the financial standing and operational reliability of NYSEG and RG&E on a going forward basis, after the merger has been consummated. Moreover, in addition to that intent, Iberdrola, as one of the most preeminent and

[30] Moody's Global Credit Research: "Credit Opinion: Iberdrola S.A.," December 13, 2007.

[31] S&P Research Update: "Spain's Iberdrola Affirmed at 'A-/A-2' on IPO Completion; L-T Rating Off Watch; Outlook Stable," December 13, 2007.

respected utility holding companies in the world, also possesses the wherewithal to deliver on those promises.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes it does.

BY MR. JARED JOHNSON:

Q. Mr. Fetter, turning to your exhibits. Were the following exhibits prepared by you or under your direction or provided by another party in response to an information request or interrogatory in this proceeding: Exhibit SMF-1, your curriculum vitae, Exhibit SMF-2, an SMP research publication entitled, "US Electric Utility Companies: strongest to weakest," Exhibit SMF-3, an SMP research report entitled, "US Utilities Ratings Analysis Now Portrayed in the S&P Corporate Ratings Matrix," Exhibit SMF-4, Moody's report, entitled, "Moody's Downgrades Iberdrola to A3P2 Stable Outlook," Exhibit SMF-5, a Staff -- Staff responses to IBER/EEIR Number 27 and IBER/EEIR Number 51. And finally, Exhibit SMF-6, an SMP research report entitled, "Energy East Corporate" dated November 16, 2007?

A. Yes, I prepared all those or with regard to the data requests, they were Staff responses.

MR. JARED JOHNSON: Thank you.

Your Honor, may we have these exhibits marked for identification.

JUDGE EPSTEIN: Yes, those will be 64 through 69.

(Exhibits 64 through 69 marked for identification.)

MR. JARED JOHNSON: Thank you, Your Honor. The witness is now available for cross-examination.

CROSS EXAMINATION

BY MR. VAN RYN:

Q. Good afternoon.

A. Good afternoon.

Q. Could you turn to page 22 of your testimony.

A. I am there.

Q. And you state that Iberdrola has coverage -- you state that Iberdrola has coverage ratios commensurate with an A rating; is that correct?

A. Yes. I cite reports from S&P and Moody's to that effect.

Q. And if you look at page 33 of your testimony you say that Iberdrola has an FFO interest coverage of 3.9 times and FFO total debt of 18.5 percent; is that correct?

A. That was for 2006.

Q. Subject to check would you accept that Standard & Poor's guidelines for an A rating are FFO interest coverage of 4.25 times and FFO total debt of 27 percent?

A. Which document are you referring to?

Q. Standard & Poor's Harvard ratings criteria for power companies.

A. What year was that done?

Q. You can find it at Staff policy panel 15.

A. I think I saw it. I didn't see a date on it. I was wondering if you have the entire document.

MR. JARED JOHNSON: Your Honor, could we take a minute to get a copy of the document to the witness.

MR. VAN RYN: Sure.

A. I found it and I note that I don't see any date on the document.

MR. VAN RYN: Staff will have to supply that, Your Honor. The witness also points out it's policy panel 17 -- Staff policy panel 17.

Q. Would you compare the interest coverage and total debt figures for Iberdrola to those shown on the chart on page 33 and give us your conclusions.

A. Well, as I mentioned in my testimony, a date for this document would be very important because on November 30th, 2007 S&P issued a new document and moved away from its prior ranges for financial ratios.

Q. That was for domestic companies?

A. It was for -- actually it was for domestic and -- yes, it's for domestic utility companies. And I believe it's one of the exhibits to my testimony.

Q. Do you believe that would apply to a European company?

A. As I mentioned in regard to a data request, since November 30th, 2007 I have not seen that S&P has provided any ranges for a European utility company.

What I can say is that in December S&P issued a report in which it noted the financial ratios for Iberdrola and indicated that they were consistent with the A rating as I noted in my testimony.

Q. Returning to the question: Can you compare the financial standards you gave us to the ones on this chart?

A. The ones from 2006?

Q. Yes.

A. One can take those dated numbers and compare them to a dated report. I think it's much better to take more recent numbers from December and -- within the same document take S&P's opinion on what those numbers mean.

MR. VAN RYN: Your Honor, I have here a recent credit analysis from Moody's for Iberdrola dated February 2008. I would like it marked for identification.

JUDGE EPSTEIN: 70.

(Exhibit 70 marked for identification.)

Q. Could you turn to page 12.

A. I am there.

Q. There it states, "The financial risk profile for Iberdrola is expected to stay weakly positioned for its rating category."

A. Can you direct me to the paragraph.

Q. It says it in the heading.

A. That's what the heading says.

Q. Please turn to page 5 of your testimony.

A. Of my testimony?
Q. Yes.
A. I am there.
Q. On there it appears you are critical of Staff's statement that credit ratings are snapshots of the Company's existing circumstances; is that correct?
A. I am critical of that statement.
MR. VAN RYN: Your Honor, I would like marked for identification a document containing two articles on the snapshot character of credit company ratings.
JUDGE EPSTEIN: 71.
(Exhibit 71 marked for identification.)
Q. The first of these articles beginning on page 1 is from the New York Times and the second beginning on page 3 is from the Wall Street Journal.
Do these articles relate to recent problems in the subprime mortgage market?
If you could look down four paragraphs --
A. On the first page?
Q. -- on the first page to the last sentence in that paragraph. Could you read that for us?
A. Read the fourth paragraph?
Q. The last sentence in the fourth paragraph, "In recent months?"

A. "In recent months the agencies have quickly, though critics say belatedly, downgraded hundreds of mortgage bond ratings."

Q. Would you say that quickly and belatedly indicates that sometimes credit ratings are just a snapshot of the circumstances?

A. No. I still -- for the reasons I give in my testimony I do not view them as snapshots and I don't think this sentence indicates that.

I think this sentence indicates that with regard to the subprime or the mortgage bond ratings the agencies, through engaging additional information and perspective, determined that they should downgrade a large number of those types of securities.

Q. Could you please turn to page 7 of the document.

A. Is it the one with 7 at the bottom?

Q. Yes.

A. I am there.

Q. If you could read the last sentence in quotations on that page.

A. I lost where you want me to go.

Q. The very last sentence on the page begins with a quotation mark.

MR. JARED JOHNSON: Your Honor, I ask--if the witness needs a minute to put this in context I ask that he have that before he starts reading quotations.

MR. VAN RYN: Sure. He can have as much time as he likes to read it and think about it.

A. The last sentence on page -- my page 7 is not in quotes.

JUDGE EPSTEIN: Is it the "despite then" that's on the bottom of page 7?

MR. VAN RYN: Yes, I believe it is, Your Honor.

JUDGE EPSTEIN: Okay. That's the penultimate sentence on the bottom of page 7.

MR. VAN RYN: Guess what, I am wrong. Thank you for the correction.

A. I am still trying to get my hands around penultimate.

I am reading the whole paragraph for perspective before I say anything aloud.

Q. Thank you.

A. Now, what do you want me to read?

Q. If you could read the sentence in quotations.

A. "Despite all that data your original predictions with the performance of 2006 loan pools have proven to be completely and utterly wrong."

Q. Do you believe that indicates sometimes credit ratings are just a snapshot of current conditions?

A. No. I -- for the same reason I gave before, which is the rating agencies getting additional information and new perspective and made changes to ratings which are not a snapshot in time, it represents their new perspective with regard to these unusual instruments going forward.

Q. From time to time it's correct that companies made presentations to credit rating agencies like S&P's and Moody's; is that correct?

A. That's an accurate statement.

Q. Do you have available to you the most recent presentations that Iberdrola has made to Moody's and S&P's?

A. I don't believe so.

MR. VAN RYN: Your Honor, I would like to make a transcript request for those if there have been any since the last the Company supplied to us. There may not be.

MR. SCHWARTZ: Your Honor, I don't know if Iberdrola fully understands what's being requested here and the relevance for it. Is the question whether there are ratings agencies presentations that deal with Energy East?

MR. VAN RYN: No, Iberdrola's overall credit rating.

I think all we are asking here is if they've made any presentations that have changed anything in the prior presentation Staff has seen.

MR. SCHWARTZ: We could certainly agree to identify any changes.

MR. VAN RYN: Thank you. I have nothing further, Your Honor.

MR. MAGER: I do.

JUDGE EPSTEIN: Mr. Mager.

BY MR. MAGER:

Q. You indicated previously that rating agencies often will meet with the utilities that they evaluate. Is that what you testified to?

A. Yes, along with meeting with regulators and Staff and basically any individuals who can provide the rating agency and its analyst with relevant information.

Q. Okay. And so when a rating agency discusses a utility's strategy, for instance, it's likely that that information has come from the utility itself in many cases?

A. Usually the utility will make a presentation and then the rating agency individuals will ask questions or request additional information, but the Company would make a presentation.

Q. Could you look at what's been marked as Exhibit 70, which is a Moody's document, which I believe you have in front of you. It was marked during the cross-examination by Staff.

A. Yes.

Q. That's that document.

A. I have that.

Q. And that was published by Moody's in February of 2008?

A. Yes. That's my understanding.

Q. And can you turn to page 10 of that document.

A. I am there.

Q. When there is a section that says "North America," the -- Moody's is defining Energy East Corporation as EEC; is that correct?

A. Yes.

Q. Now, the third paragraph under that heading it states, "The acquisition of EEC, a group of regulated gas and electric utility companies in the northeastern of the USA, will reinforce Iberdrola's position in the US following its acquisition of the US renewables unit PPM from Scottish Power and will provide it with a taxable income which it can utilize in its US renewables business which is supported by certain tax incentives."

Do you see that?

A. I see that paragraph.

Q. Is that indicative of information that the credit rating agency is likely to get from the utility?

A. I'll read it again, if that's okay.

Q. Certainly.

A. Now, could I hear the question again.

Q. Certainly. Is that type of information indicative of the information that a rating agency is likely to get from the utility?

A. Well, this paragraph includes kind of two concepts related to your question. The first is with regard to the specifics they would get that kind of information during a presentation.

With regard to whether it will reinforce, a Company might offer its opinion with what certain facts will lead to, but the rating agency has to agree and be comfortable before they would put it out as their opinion.

Q. So, when Moody's suggests that the acquisition of Energy East may provide it with taxable income which it can utilize in its renewables business, that information not only likely would have been provided by Iberdrola but also Moody's would have to agree with that assessment?

A. Well, I was thinking more about the phrase, will reinforce as more of an opinion as opposed to provide it with a taxable income which it can utilize in its US renewables business which is supported by certain tax incentives.

I would view that phrase as more factual as opposed to opinion. And so I would guess that is information that would have been provided. And as long as Moody's does not have a reason to believe it's not accurate would include in its report.

Q. How timely are these reports usually?

A. What do you mean by "timely"?

Q. This is published in February 2008 at some point. Would that be -- they would rely on, I am guessing, pretty recent information and communications with the utility to prepare this?

A. There is usually at least a couple of presentations a year. And if in a situation like this with a major acquisition there might be more, but there are certainly ongoing interactions by phone and that sort of thing.

And so I would expect that Moody's had put out a report that I believe is one of my exhibits in December. And now it's published. This is February. And this is much more substantial than the two or three pages in December.

So I would expect they did a lot of research and interaction with Iberdrola in order to bring this report up to publishing standards.

MR. MAGER: Thank you. I have nothing further, Your Honor.

JUDGE EPSTEIN: Mr. Brew.

MR. BREW: Thank you. Just to follow up on this, Mr. Fetter.

BY MR. BREW:

Q. Would a draft like this be vetted with the utility for accuracy?

A. Back when I headed the Fitch group we'd provide a draft to make sure it's factually correct, but we would not let an issuer edit our opinions.

Q. Right, but the statement you just talked about in terms of the taxable income, statements like that would be checked for factual accuracy?

A. When I was at Fitch we did it. I would expect Moody's would do the same thing.

MR. BREW: Thank you.

JUDGE EPSTEIN: Further cross? Redirect?

MR. JARED JOHNSON: Your Honor, I would just like to ask for a minute.

JUDGE EPSTEIN: Sure.

MR. JARED JOHNSON: I just have a couple of questions.

REDIRECT EXAMINATION

BY MR. JARED JOHNSON:

Q. Mr. Fetter, Staff asked you a question from a Moody's 2008 credit report regarding Iberdrola. Do you still have that in front of you?

A. I do.

Q. On page 12 you were referred to a heading that says "Financial Risk Profile Is Expected To Stay Weakly Positioned For Its Rating Category," which might suggest that Iberdrola's credit rating could soon be revisited downward.

Could you explain how you interpret that?

A. In fact, it's interesting because from just the heading it would appear what you said, Mr. Johnson, that we are looking at a downward step soon to come.

But when you actually read the section under that heading it leads to a very different conclusion. Near the bottom of the page starting with the words "Moody's notes" -- and I'll just read from there, "Moody's notes, however, that the Company is large and diversified which should help mitigate the commodity and regulatory risks in its portfolio."

And then it goes on to say, The Company has stated that it is committed to an A3 rating, and then Moody's offers its opinion that the Company has demonstrated a judicious use of equity to fund its acquisitions and has also committed to maintain a leverage of 50 percent. We therefore believe that it will use reasonable means at its disposal if necessary to maintain an A3 rating profile.

And in fact, earlier in the report the same idea was introduced by Moody's on page 4 under the section entitled, "Key Rating Consideration." The very last phrase under that section states, "Moody's would expect the Company to use means at its disposal to maintain its financial targets and its commitment to a rating in the A category."

And I know that that has been a theme that Moody's has stated over the last year or two with regard to the Company's commitment to the A category.

Q. Thank you. Just one other question. Turning to page 11 of the Moody's report. At the top of that page there is a paragraph which discusses the negative outlooks for Energy East and it also discusses -- has some discussion regarding the proposed transaction.

Could you comment on your view of what this part of the Moody's report says about the relative financial health of Iberdrola and its ratings as compared to Energy East?

A. In fact, Mr. Johnson, with regard to the part of your question about this proposed transaction, let me start on page 12 and then return to page 11.

On page 12, in the next to last paragraph on the page, is the statement, "The rating, which is the A3, also factors in completion on the EEC transaction but does not assume acceptance of unduly harsh conditions related to regulatory approval of the transaction nor to the current rate review which EEC and its subsidiaries are undergoing."

So it's clear Moody's is focusing on what kind of regulatory conditions might come out of this review. And they give as an example on page 11 some of the negative ramifications that can come out of a nonsupportive regulatory decision.

That's the very first sentence on page 11. "The negative outlooks for EEC and its subsidiaries reflect in part the financial and operating challenges resulting from a surprisingly unfavorable decision NYSEG received in its general rate case decided in August 2006."

MR. JARED JOHNSON: Thank you, Mr. Fetter.

Your Honor, that's all I have on redirect.

JUDGE EPSTEIN: Anything further?

MR. VAN RYN: I have nothing further, Your Honor.

JUDGE EPSTEIN: Okay. Thank you, Mr. Fetter. You are excused.

We will reconvene if it's agreeable to everyone at 9:00 a.m. tomorrow in the third-floor hearing room. And as I mentioned, we are obligated to clear out this room tonight. The third-floor hearing room is secured to the same extent as this one. In other words, it's locked except for the cleaning crew. If you need more secure arrangements than that I can discuss that with you.

(Hearing adjourned.)

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